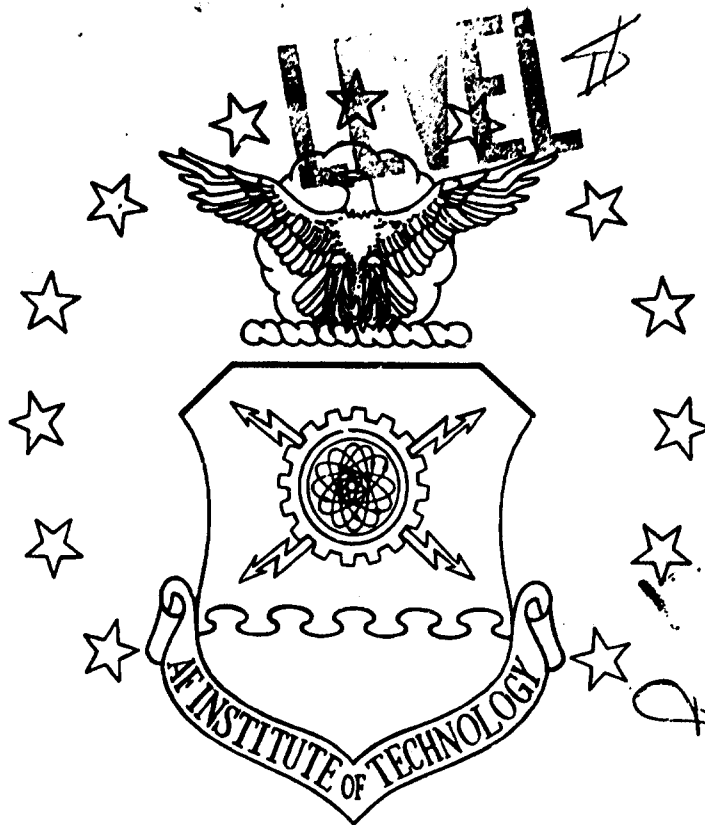


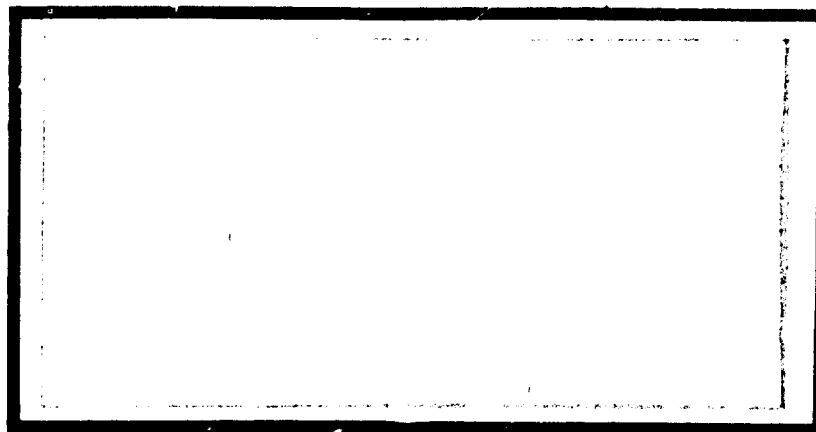
ADA070474

DDC FILE COPY



79-25
B. S. 1

REC'D DDC
JUN 21 1973
RECEIVED



UNITED STATES AIR FORCE
AIR UNIVERSITY
AIR FORCE INSTITUTE OF TECHNOLOGY
Wright-Patterson Air Force Base, Ohio

This document has been approved
for public release and sale; its
distribution is unlimited.

79 06 25 073

①

Accession For	
NTIS Grant	<input checked="checked" type="checkbox"/>
DDC TAB	<input type="checkbox"/>
Unannounced	<input type="checkbox"/>
Justification	
By	
Distribution/	
Availability Codes	
Dist.	Avail and/or special
A	

DDC
REFRAN
JUN 26 1979
RECEIVED
C

TERMINATION FOR CONVENIENCE COSTS

By

CHARLES GORDON JONES

This document has been approved for public release and sale; its distribution is unlimited.

DEPARTMENT OF THE AIR FORCE
AIR FORCE INSTITUTE OF TECHNOLOGY (ATC)
WRIGHT-PATTERSON AIR FORCE BASE, OHIO 45433



22 January 1979

REPLY TO
ATTN OF: CISC

SUBJECT: Request for Evaluation of Independent Research Accomplished by
Captain Charles G. Jones, 509-44-6743

TO: HQ USAF/LGP
Washington DC 20330

1. Air Force Institute of Technology graduate students are encouraged to select research topics related to Department of Defense problems to fulfill thesis or dissertation requirements. In an effort to document the value of AFIT graduate research, Civilian Institution Programs (CI) is requesting DOD organizations to evaluate research accomplished in their particular area of interest.
2. Attached is the subject research work entitled: "Termination for Convenience Costs." Your support is requested in reviewing and evaluating this work to determine its present or possible future value. Please provide your comments on the attached AFIT Research Questionnaire. Your response will be used to compile a statistical data base which will help us to improve our research efforts. Please return the attached thesis so that it may be submitted for further evaluation and eventual input into the Defense Documentation Center.
3. If you have any questions regarding this thesis, please contact Captain Harry H. Hughes at AFIT/CIRF, Wright-Patterson AFB OH 45433; Autovon 785-3151. Your support in this effort is greatly appreciated.

FOR THE COMMANDANT

JIMMIE KUSEL, Colonel, USAF
Dean
Civilian Institution Programs

2 Atch
1. Questionnaire
2. Thesis

Strength Through Knowledge

UNCLASSIFIED

SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

REPORT DOCUMENTATION PAGE		READ INSTRUCTIONS BEFORE COMPLETING FORM
1. REPORT NUMBER CI 79-25T ✓	2. GOVT ACCESSION NO.	3. RECIPIENT'S CATALOG NUMBER
4. TITLE (and Subtitle) Termination for Convenience Costs 0	5. TYPE OF REPORT & PERIOD COVERED Thesis	
7. AUTHOR(s) Charles Gordon/Jones	6. PERFORMING ORG. REPORT NUMBER	
9. PERFORMING ORGANIZATION NAME AND ADDRESS AFIT student at George Washington University	8. CONTRACT OR GRANT NUMBER(s)	
11. CONTROLLING OFFICE NAME AND ADDRESS AFIT/CI WPAFB OH 45433	10. PROGRAM ELEMENT, PROJECT, TASK AREA & WORK UNIT NUMBERS 12 178p.	
14. MONITORING AGENCY NAME & ADDRESS (if different from Controlling Office) AFIT-CI-79-2571	12. REPORT DATE 30 September 1977	
	13. NUMBER OF PAGES 170	
	15. SECURITY CLASS. (of this report) UNCLASSIFIED	
	15a. DECLASSIFICATION/DOWNGRADING SCHEDULE	
16. DISTRIBUTION STATEMENT (of this Report) Approved for Public Release, Distribution Unlimited		
17. DISTRIBUTION STATEMENT (of the abstract entered in Block 20, if different from Report)		
18. SUPPLEMENTARY NOTES 13 MAR 1979 JOSEPH R. HIPPS, Major, USAF Director of Information/AFIT		
19. KEY WORDS (Continue on reverse side if necessary and identify by block number)		
20. ABSTRACT (Continue on reverse side if necessary and identify by block number)		

DD FORM 1 JAN 73 1473

EDITION OF 1 NOV 65 IS OBSOLETE

UNCLASSIFIED

SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

SECURITY CLASSIFICATION OF THIS PAGE(When Data Entered)

SECURITY CLASSIFICATION OF THIS PAGE(When Data Entered)

Termination for Convenience Costs

By

Charles Gordon Jones

A.B. 1967, Washington University

J.D. 1970, Stanford University

A Thesis submitted to

The Faculty of

The National Law Center

of The George Washington University in partial satisfaction
of the requirements for the degree of Master of Laws

September 30, 1977

Thesis directed by

Gilbert Jerome Ginsburg

Professor of Law

Accession For
 WIS G&I
 DOC TAB
 Unannounced
 Justification

By
 Distribution
 Availability
 Dist

Special

A

TABLE OF CONTENTS

FOREWORD	1
I. INTRODUCTION	1
II. TERMINATION COSTS	8
A. Overview	8
B. Common Items	17
1. Burden of Proof	17
2. Government Advantage	18
3. Overlap with Other Cost Principles	20
4. Subjective Test	24
C. Costs Continuing After Termination	26
1. Allowability	26
2. Importance of Factual Proof	29
3. Unabsorbed Overhead	31
4. Personal Services and Interest Charges	38
D. Initial Costs	42
1. Precontract Costs	43
2. Preparatory and Starting Load Costs	48
3. Allocation After a Partial Termination	56
4. Overhead	57
E. Loss of Useful Value	61
1. When Is the Cost Allowable?	62
2. Special Tooling and Special Equipment	68
3. Special Tooling Versus General Purpose Tooling	73
4. Title to Special Tooling	75
F. Rental Costs Under Unexpired Leases	77
1. Allowability Beyond Contract Completion date	78

2.	Similarity to Continuing and Initial Costs	85
3.	Reasonableness Test	87
4.	Other Rental Claims	89
G.	Settlement Expenses	93
1.	Attorneys Fees	94
2.	Accountants Fees	107
3.	Clerical and Other Reasonably Nec- essary Expenses	114
4.	Storage, Protection, and Allowable Indirect Costs	120
H.	Subcontractor Claims	123
1.	G & A	125
2.	Profit on Subcontractor Settlements . .	127
3.	First Article Approval	128
4.	Judgment and Litigation Costs	130
III.	UNALLOWABLE COSTS	133
A.	Appeal Costs	133
B.	Unabsorbed Overhead	137
IV.	CONCLUSION	144
	FOOTNOTES	152
	SOURCES CONSULTED	166

FOREWORD

The author is a Captain, Judge Advocate, United States Air Force. The views and opinions expressed herein are solely those of the author and do not purport to reflect the position of the Department of the Air Force, Department of Defense, or any other agency of the United States Government.

The author acknowledges with sincere appreciation the professionalism, enthusiasm, and dedication of Dorothy Kerwin who was indispensable in the typing and preparation of this paper.

I. INTRODUCTION

The right of the Government to terminate a contract for its convenience, even though the contractor is not at fault, and to enter into a binding settlement agreement with the contractor has been recognized since the case of United States v. Corliss Steam Engine Co.,¹ decided over 100 years ago. It has been stated that, "[t]he approval of the negotiated settlement of the Corliss claim proved to be the cornerstone of the contract termination and settlement procedures which have become so integral a part of the Government contract law of today."² However, even with the right to terminate for convenience, the Government still was responsible to the contractor for breach of contract, unless there was a clause in the contract which provided for the right to terminate for convenience.³

The use of a termination clause has been traced back to the Civil War,⁴ but no statute expressly provided for the Government's right to terminate for convenience until the Contract Settlement Act of 1944,⁵ which provided for a post-termination process of arriving at a "fair compensation" through a process of negotiation. The contracts settled under this Act were applicable to the nation's war effort in World War II.⁶ A Uniform Termination Article was developed for use

in these contract settlements, and between 1 July 1944 and 31 March 1947, approximately 319,000 convenience termination settlements were accomplished.⁷

For Government defense contracts entered into after 19 May 1948, the effective date of the Armed Services Procurement Act of 1947,⁸ the Contract Settlement Act of 1944 does not apply. Although the existing statute does not specifically provide for the Government's right to terminate for its convenience, the Armed Services Procurement Regulation⁹ (ASPR) does so provide and makes a Termination for Convenience clause mandatory in most Government contracts.¹⁰ Even though the clause is required to be present, there may be occasions when it is physically left out. The Court of Claims rectified this situation in an opinion which decided that since the procurement regulations have the force and effect of law, a contract can be read as incorporating a required Termination for Convenience clause despite the fact it was not present in the contract.¹¹

The existence of the termination provision, besides clarifying the Government's right to terminate "whenever the Contracting Officer shall determine that such termination is in the best interests of the Government,"¹² also is salutary to the Government's interests because it negates any duty to pay anticipatory profits for what would otherwise be a common law breach situation,¹³ and it sets forth definite duties to be accomplished by the contractor upon termination.¹⁴

As for the contractor, one aspect of the convenience termination situation that is favorable to him is that he can be compensated for certain costs even though no benefit ever passed to the Government in the form of a contract end product. This situation is at least preferable to a cancellation by the Government in which the contractor would be able to get only quantum meruit, i.e., the value of the goods and services given to the Government before the cancellation.¹⁵

Most of the civilian agencies are governed by the Federal Procurement Regulations,¹⁶ (FPR) which are very similar to the ASPR in their treatment of the Government's right to terminate for convenience. Since the defense agencies utilize their power to terminate for convenience with much greater frequency than the civilian agencies,¹⁷ particularly since the need for flexibility in military procurement is so high, only the ASPR will be cited. However, should the FPR references be useful, most of the discussion will involve ASPR 15-205.42, which, with only minor editorial variation, is identical to FPR 1-15.205-42.

In January of 1952, termination procedures and policies were formally established under Section VIII of the ASPR.¹⁸ These termination principles were altered slightly in November of 1959, and were relocated to Section XV of the ASPR at that time. Section XV became particularly important as far as terminations for convenience were concerned after the promulgation of Defense Department Circular 79 on 15 May 1970.

This directive added fixed price contracts to the scope of Section XV, which had previously only applied to cost reimbursement type contracts (with other than educational institutions).¹⁹ The Cost Principles of ASPR Section XV are particularly important since they are to be used in all actions to claim, negotiate, or determine costs relevant to termination settlements.²⁰ The contract Termination for Convenience clause makes these principles specifically applicable to the calculation of the termination settlement whether it is arrived at through negotiations or a unilateral decision of the contracting officer.²¹

Even though it has been estimated that as many as 99 percent of the termination claims are settled by negotiation between the contractor and the contracting officer,²² there are still substantial numbers of occasions when the two parties cannot arrive at a negotiated settlement, and the contracting officer then must unilaterally settle the claim under the "formula" set forth in the Termination for Convenience clause.²³

Although there are very few Comptroller General opinions and United States Supreme Court decisions involving convenience termination settlement costs, there are several Court of Claims decisions and scores of Armed Services Board of Contract Appeals²⁴ (ASBCA) cases dealing with this subject. It has been estimated that approximately 8 percent of all ASBCA opinions concerns terminations.²⁵ During a recent two-year period

there were approximately 75 ASBCA termination for convenience cases of which approximately one-half concerned the quantum of recovery, and the remainder related mainly to whether or not a termination for convenience had occurred;²⁶ in many of the cases, however, both issues appeared.

The decisional law on termination settlements is probably significantly more important than would be presumed from the fact that it represents a disposition of only a very low percentage of all termination claims. To the extent this law sets forth clear rules and interpretations of the Termination for Convenience clause and the numerous complicated Cost Principles applicable to this subject, the board potentially encourages more claims to be settled by negotiation. This represents a furtherance of the policy favoring the resolution of termination claims by negotiation.²⁷

Thus, one of the features of the board decisions is that they present the opportunity, through treatment of the contractor in a manner which is both fair and predictable in accordance with the body of case law on termination settlements, to encourage the settlement by negotiation. To the extent the parties perceive that there is certainty as to the board's decision on a possible issue, there will be a greater acceptance of the advisability of simply settling the matter by negotiation. The attainment of certainty is one of the primary reasons for the contract,²⁸ as it reflects the reality that "one of man's most vital interests in a social setting

is in the fulfillment of those expectations that have been aroused in him by the voluntary conduct of other men."²⁹

However, one of the problems with the attainment of some degree of certainty is that the board's decisions are often heavily weighted with the factual setting of each individual situation. This is an understandable consequence of the fact that the board is not a court of law, either as an appellate tribunal or trial court; it is an administrative body with a mission requiring the determination of facts which can then be applied to the contract and applicable regulatory provisions of the ASPR. One of its major problems, therefore, concerns its ability to develop the necessary interstitial guidance necessary when the administrative regulations do not so provide. This is particularly a relevant difficulty in the area of post-termination costs, since "[t]he regulations dealing with post-termination costs (ASPR 15-205.42; FPR 1-15.205-42) are neither comprehensive nor completely clear. There are in fact serious omissions in their coverage, and some of their provisions are ambiguous and inconsistent. As a result, both the Government and contractors are often unable to sensibly determine whether a particular cost is recoverable."³⁰

The question of what the contractor can claim and expect to receive upon a termination for convenience has not been treated extensively in the Government procurement literature. Even to the extent that convenience termination settlements

arise as a topic for discussion, there is virtually no elaboration on termination costs.³¹ The principal concern here will be to survey the regulatory and decisional law on post-termination costs. The primary regulatory provisions applicable to this topic are found, as mentioned above, in Section XV of the ASPR in the Cost Principles of 15-205.42. Since these Cost Principles³² are mandatorily applicable to the Termination for Convenience clause, substantial attention will be given to these provisions. The purpose of this effort is to determine the degree of certainty that exists as to the allowability of the various kinds of post-termination costs which may be claimed by a contractor, and to relate this to the Government's express purpose of compensating the contractor for the effects of its exercise of the right to terminate for convenience.

II. TERMINATION COSTS

ASPR 15-205.42, paragraph 1:

15-205.42 Termination Costs. (CWAS-NA) Contract terminations generally give rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the contract not been terminated. Cost principles covering these items are set forth below. They are to be used in conjunction with the remainder of this Part in termination situations.

A. Overview

There are seven Termination Cost Principles (ASPR 15-205.42(a)-(g)); however, not all of these provisions have given rise to substantial amounts of litigation. For instance, ASPR 15-205.42(a) is cited only occasionally in the literature and in the cases; but ASPR 15-205.42(f), dealing with settlement expenses, is almost routinely at issue.

Some of the Termination Cost Principles are reflections of specific provisions of the Termination for Convenience clause of the contract³³ and appear in that part of the clause which spells out the "formula" that the contracting officer is to follow in determining a settlement when agreement by negotiation fails. For example, initial costs are allowable under paragraph (e)(ii)(A) of the termination clause, as they are under ASPR 15-205.42(c); likewise, the cost of settling and paying claims arising from subcontracts is allowed

specifically under paragraph (e)(ii)(B), as it is under ASPR 15-205.42(g); and the cost of settlement, including legal, accounting, and clerical costs of making the settlement claim, is provided for under paragraph (e)(iii), as it is under ASPR 15-205.42(f).

Thus, ASPR 15-205.42(a), (b), (d), and (e) are items which are not specifically mentioned as allowable termination costs under the termination clause of the contract, but which represent important contractor compensation rights under the Cost Principles of ASPR 15-205.42. There is really no discrepancy between the contractual Termination for Convenience clause and ASPR 15-205.42 since the clause specifically states in paragraph (f) that the determination or agreement of costs shall be in accordance with ASPR Section XV³⁴ in effect as of the date of the contract. Thus, failure to mention all of the allowable termination costs in the contract, despite the fact some of them are prominently mentioned, does not make them unallowable.

The Government would in general prefer that convenience termination settlements be arrived at by agreement between the contractor and the contracting officer under the provisions of paragraph (d) of the Termination for Convenience clause. This method of claims settlement obviates the need to formally apply the Termination Cost Principles and the settlement formula to the facts of every separate item in the termination claim. This will result normally in a savings of Government

administrative cost and effort in settling the termination claim. The contracting officer, in negotiating a settlement, need not be bound by what the formula settlement under paragraph (e) of the termination clause would allow since paragraph (d) states that paragraph (e) will not "limit, restrict, or otherwise determine or affect the amount or amounts which may be agreed upon to be paid to the contractor pursuant to this paragraph (d)." ³⁵

This provision can be a smoke screen for the unwary, as it can be read to imply that a negotiated settlement will be more lucrative than a formula determination. Thus, counsel for the contractor, if he were not experienced in Government procurement contracts, particularly terminations, as well he might be if he is perhaps an in-house counsel of a small contractor who does little Government contract work, may very well conclude from reading of the contract Termination for Convenience clause that it would always be in his client's best interests to agree to a negotiated settlement with the contracting officer.

This may be true, but the negotiated settlement doesn't always give the most return, nor is it necessarily speedy. The contracting officer will not act until he receives a proper claim, which must be filed within one year from the effective date of the termination. ³⁶ If no agreement is able to be reached, the contracting officer may even wait at least this long before he makes his unilateral decision, or longer if

negotiations are continuing. There is no incentive in most cases for the contracting officer to make a decision any sooner than he has to, since the Government is holding the money and has the use of it until there is a settlement.

However, the contractor can attempt to get at least a partial payment on his claim as long as there is no dispute as to the severable part of the claim for which he wants compensation, and if such procedure will not prejudice the Government or the contractor in settling the remainder of the claim.³⁷

There is one occasion in which the Government may wish to make an expeditious settlement. In a partial termination for convenience situation when it is clear that it would be in the best interests of the Government to pay the contractor as soon as possible to alleviate a precarious financial condition, then it may be beneficial to promptly pay, so as to keep the contractor financially afloat long enough to complete the rest of the contract. But normally, there is no incentive at all for the contracting officer to make an expeditious unilateral settlement or agree to a liberal settlement with the contractor on a negotiated settlement.

The contractor may find himself in an inferior bargaining position vis-a-vis the Government. Since the contract was likely wholly or partially terminated before the contractor could recover very much of his cost of performance and cost of preparation to perform, which he had planned to recover

over the life of the contract, he may be in a disadvantageous financial condition. The Government certainly has the financial resources to always be in a more strategic position for negotiation purposes. Not only does the Government have a deeper pocket, but it virtually has its hand over the pocket in view of the fact that it can hold the contractor's recoverable termination costs, barring a partial payment, for the months or even years it takes to settle a claim.

Thus, time and the need for money are not factors which will drive the Government to settle or make a unilateral decision rapidly, but these are considerations which could result in the contractor making a hasty claim, leaving out allowable items in the claim which might cause difficulty in the negotiations and failing to gather the necessary documentation to support the claim. The end result may well be that some agreements are negotiated, or some unilateral settlements accepted, out of necessity, particularly with small contractors or those with little experience dealing with the Government.

This is particularly why it is important for a Government contractor to be keenly aware of his rights after a termination for convenience, and especially those costs which are allowable upon termination. With this knowledge at hand, the contractor is in a better position to put his best case before the contracting officer. And, if this is not successful, at least the contractor will be aware of his rights enough to gauge the probability of success before the board.

If he proceeds to the board, he should do so under the general proposition that he is there so that the board, to use a term which has been cited by both the board and the Court of Claims, can make him "whole"³⁸ for the effects caused by the Government's exercise of its termination power.

This does not necessarily mean that the mission of the contracting officer is to make the contractor whole. The contracting officer is not a judge, nor does he have to necessarily have a legal background. "While an equitable settlement is the goal of the negotiations, the amount is determined by adversaries, not judges."³⁹ A contracting officer will not be unaware that the contractor may not have the time or resources to wage a fight for a higher settlement to the Board of Contract Appeals or the Court of Claims, and therefore he is essentially the final agency approval authority on many claims.

A settlement may very well be a positive careerism achievement for a contracting officer, since it could give him a better record with his superiors if he can say that he saved a difficult and possibly more expensive case from going to the board. Besides the fact that the contracting officer has some incentive to negotiate, as does the contractor in terms of saving settlement time and promptly recovering the costs expended in preparing and performing before the termination, there is another factor favoring negotiation.

As was mentioned above, paragraph (d) of the termination clause allows the negotiation of a settlement without reference to the formula settlement set forth in paragraph (e). The contracting officer thus could point to several different provisions under paragraph (e) which he does not need to apply if the contractor will agree to a negotiated settlement:

i.) In paragraph (e)(i) there is a provision indicating that the contracting officer must adjust for "freight or other charges."

ii). Profit under paragraph (e)(ii)(c) must be "fair and reasonable," whereas under paragraph (d) it must only be "reasonable." The implication is that specific consideration must be given to what is "fair" to the Government, not just to the contractor, when a formula settlement is used.

iii). Settlement costs are spelled out in more detail under paragraph (e)(iii) than they are in paragraph (d) where they are only mentioned. Thus, such things as unabsorbed overhead, a topic which will recur and be discussed in greater detail later, could conceivably be more appropriately considered under a paragraph (d) settlement than one under paragraph (e).

v). Paragraph (e) also indicates that any settlement thereunder must be adjusted by excluding any property which has been "destroyed, lost, stolen, or damaged so as to become undeliverable to the Government." This provision likewise does not expressly appear under paragraph (d) which means that

the contracting officer does not have to specifically consider this unless it is otherwise required to be considered by Section XV of the ASPR in effect on the date of the contract.⁴⁰

Although the purpose of paragraph (f) of the termination clause is to bring uniformity to termination settlements, both bilateral agreements and unilateral decisions, since the Cost Principles of Section XV are to apply to both types of settlements, this does not necessarily have to result unless there is some procedure to verify that the negotiated agreements are comparable to what would be rendered in a unilateral settlement. The agency itself does not have any substantial incentive to formalize a procedure for this purpose, and the board will never enter into such a review since a negotiated settlement, absent fraud or criminal misconduct, will probably not be the subject of an appeal.

The fact remains that the structure of the Termination for Convenience clause is such that it appears that a negotiated settlement should lead to the most favorable result. This increases the possibility that an unwary contractor might accept less than an optimum settlement, particularly if he has not had sufficient experience to realize that a great deal of what costs he has incurred are not expressly allowable under the termination clause but are protected in the termination Cost Principles and the decisional law. The relative dearth of case law on ASPR

provisions 15-205.42 (a), (b), (d), and (e) might be reflective of the fact that these items are not addressed specifically in the Termination for Convenience clause. There may well be a tendency to litigate items such as ASPR 15-205.42(c), (f), and (g) to a greater extent since these items are specifically mentioned in the clause. Thus, a contractor may very well keep more accurate accounting records on these types of costs, since they are obviously allowable, and thus be in a better position for negotiation and litigation on only these matters.

Even assuming that the contractor is fully aware in advance of the provisions in the termination clause and, by reference from paragraph (f) of the clause, is also aware of the applicability of the Cost Principles, there still is a need to be aware of how the board and the Court of Claims have interpreted these provisions. The following discussion will review the Termination Cost Principles as they have been applied in convenience termination settlement decisions, and relate this, wherever possible, to the concept that the contractor should be made whole by the board or the court. Knowledge gained from the decisional law is a necessity for effective negotiation with the contracting officer. The contractor must be aware of what he could expect to recover in the event he has to appeal, and be able to produce enough evidence on these cost items to the contracting officer so that even if he is not successful at that level, he will have

a legally sufficient case available for appeal.

B. Common Items

ASPR 205.42(a):

(a) Common Items. The cost of items reasonably usable on the contractor's other work shall not be allowable unless the contractor submits evidence that he could not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the contractor, the contracting officer should consider the contractor's plans and orders for current and scheduled production. Contemporaneous purchases of common items by the contractor shall be regarded as evidence that such items are reasonably usable on the contractor's other work. Any acceptance of common items as allocable to the terminated portion of the contract should be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

1. Burden of Proof

Of the seven Termination Cost Principles in ASPR 15-205.42, this one has probably received the least attention in the decisional material. Another unique feature is that it is the only one of the seven to be written as a negative or prohibitory statement, i.e., it states that a certain cost is not allowable. The other Termination Cost Principles specify a particular cost and the circumstances under which it will be allowable to the contractor. Here, the contracting officer has only to arrive at a conclusion that a particular cost is not reasonably usable on the contractor's other work, then the burden of proof will lie with the contractor to show that "he could not retain such items at cost without sustaining a loss."⁴¹ Thus, the Government has a two-fold benefit under

this Cost Principle. First, it is able to reduce its termination settlement payment by virtue of the fortuitous circumstance that some items can be reasonably used on the contractor's other work (and the contractor's having other work is also a beneficial circumstance for the Government). And secondly, the burden of proof is on the contractor to show the items cannot be retained without incurring a loss.

2. Government Advantage

This provision potentially gives the contracting officer some degree of negotiating leverage in a termination situation since he could use this Cost Principle as a nuisance device, available for deployment against the contractor to force him to come forward with evidence, including his plans and orders for current and scheduled production, if a negotiated settlement is not agreed to. However, because there are such few cases dealing with ASPR 15-205.42(a), it appears that this is not a center for disputes, or what is more likely, it is not a Cost Principle which is asserted that frequently by the Government.

However, this principle is potentially troublesome to the contractor in another respect, as well. The only way the contractor can recover the cost of items which are "reasonably useful" on his other work is to prove that he could not retain the items "without sustaining a loss." This test is not a particularly clear-cut standard for the contractor to meet in a convenience termination situation.

One aspect of this problem is that the contractor has entered into the contract to make a profit, not to tie up his money for long periods of time in termination settlement proceedings. It may be the case that a contractor will not be able to show a loss in retaining the common items at cost, but this test does not specifically indicate that he can be compensated for the loss of use of his funds tied up in common items which may not be useful to him at the time of termination. He may be able to use the items in his other work, but he would indeed be fortunate if he could utilize them as expeditiously in other work as the contract at hand.

Also, the contracting officer is within his rights to disallow the cost of these items as long as they are only "reasonably usable" in the contractor's other work; this test does not account for the loss, inconvenience, or diminution of value of his other work if he has to use items which were not contemplated, planned, or designed for it. A contractor who is economically forced, by the outcome of the termination settlement, to use these items on his other work--since they are "reasonably usable" on that work--may suffer in ways which are not readily apparent, e.g., his other products may be qualitatively inferior and thus lose him business and good will, or his products may now be superior to his previous product but because of competitive market forces, he may not be able to recoup the marginal value of quality added to his

product. As an example, a contractor making camouflage jungle clothing for the Army may well be able to use the material for a civilian use such as backpacking wear, but the added resiliency of the fibers he produced for the military may not be required or worth the additional expense to the civilian sportsman. Even though the contractor could merchandise the material through his other work, he may have difficulty making the same profit. And, unless he can show a "loss" by retaining this material, he will be denied compensation.

3. Overlap with Other Cost Principles

One of the few board cases purporting to deal with an ASPR 15-205.42(a) problem is Colonial Metals Co.⁴² which was affirmed by the Court of Claims.⁴³ The case involved a situation where a contract to supply copper was terminated for convenience, and the claim submitted totaled over \$123,000, of which the contracting officer allowed but \$250. The largest single item of the claim was for the amount that represented the cost of settlement with the suppliers of copper ingot. The contracting officer's decision was upheld on the grounds that after the contractor terminated his contract with the subcontractor, he renewed the purchase order one week later for his own account.

Although the opinion is rather brief in its reasoning, it does appear that the board arrives at the correct result for

the wrong reasons. The contractor was apparently able to use the copper ingot on his other work, so there is no real question that this is a "common item;" however, there was an alleged "loss" involved in this transaction which the contractor attempted to prove. He had ordered the ingot on 31 December 1969, one week after award, at a price of \$.7225 per pound. On 20 January 1970, the Government terminated for convenience; on this same date the contractor terminated his contract with the supplier as he was required to do by the Termination for Convenience clause of the contract.⁴⁴ The contractor claimed the difference between the contract price and the closing market price of May 1970 copper and multiplied this times the pounds of copper originally ordered from the supplier. What is apparent is that the price of copper dropped by at least \$.0635 per pound from 31 December 1969 to 20 January 1970. Thus, even though the contractor reordered the ingot a week after termination, it was at the lower price; this meant the supplier is the one who suffered a "loss" since he was not able to sell at the higher price. If the contractor had been able to show he paid the supplier the difference in price, which he probably could not do if he had a termination for convenience clause in the subcontract,⁴⁵ he should have been able to collect this as part of the termination settlement, but as part of an ASPR 15-205.42(g) subcontractor settlement and not because it was a common item. Although the board discusses this case in terms of ASPR 15-205.42(a),

"common items,"⁴⁶ the conclusion reached is based purely on a consideration of this as an ASPR 15-205.42(g) subcontractor claim, e.g., "the amount claimed for subcontractor settlement is unsupported by evidence of such a settlement."⁴⁷

This case shows the interplay between these two Cost Principles, ASPR 15-205.42(a) and (g). In certain circumstances it could be useful for the contractor to be aware of the potentially overlapping coverage of the Cost Principles so that if he cannot meet the requirements under the provision which seems most applicable, it might be worthwhile to attempt to fit parts of his claim under a different section. As was mentioned earlier, the contractor carries the burden of proof under ASPR 15-205.42(a) after the contracting officer has determined that an item is "reasonably useful" on his other work; as will be explained later, under ASPR 15-205.42(g), the burden on the contractor is much less severe since subcontractor claims need little more than proof of payment because these claims are "generally allowable."⁴⁸ The only hurdle the contractor failed to clear in Colonial Metals Co., in order to receive payment for his alleged subcontractor termination settlement, was a showing of payment of the subcontractor claim. The contractor never had a reasonable chance of compensation under ASPR 15-205.42(a) since he repurchased at a cheaper price and could show no loss.

A case involving common items more directly is Codex Corporation,⁴⁹ in which the contractor's claim for over

\$78,000 for termination inventory was allowed to the extent of approximately \$1,600, representing that part of the costs incurred after the award of the contract. The board found the remainder of the costs "were incurred more than seven months prior to the issuance of the request for proposals and more than twelve months before the award of the contract."⁵⁰ The claimant attempted to cite three cases⁵¹ for the proposition that these costs were allowable; however, the board distinguished all of these decisions on the basis that the costs there were all incurred after the request for proposals was issued.

The contractor did present evidence to indicate that the common items reasonably usable on his other work could only be retained at a loss; his problem, and one that other contractors may also encounter, is that ASPR 15-205.42(a) does not specifically address the question as to when the costs must have been incurred in order to be allowable. In answer to this question, the board stated that because it is bound by paragraph (f) of the contract, which indicates costs will be determined in accordance with Section XV of ASPR, consideration should be given to ASPR 15-205.30 which defines precontract costs.⁵² Since ASPR 15-205.42 indicates in its first paragraph that it is to be construed in conjunction with the remainder of Part 2 of ASPR, it is clear that the precontract cost principle is applicable. And because it did not appear that the claimed costs were not, in the words of ASPR 15-205.30,

"incurred . . . directly pursuant to the negotiations and in anticipation of the award," the costs are not allowable under ASPR 15-205.30 and thus cannot be allowed under ASPR 15-205.42(a).

This result does not really further the objective of making the contractor whole; the fortuitous circumstances of having purchased early is taken advantage of by the Government, despite the fact that the items were allocated to production of the contract and would have been a direct cost of production. There does not seem to be any recourse available to a contractor who may be faced with such a situation as this except to expedite the use of all materials purchased beforehand so that he can recover their cost through payment for completed items at the contract price. To allow these items to remain in inventory is a risk the contractor should avoid if he determines a termination for convenience is likely.

4. Subjective Test

Common items was also a subject at issue in Southland Manufacturing Corporation,⁵³ where the contractor wanted to recover the loss incurred when his equipment was idled through the termination of his contract. This is somewhat of a special case in that normally the risk would be on the contractor to find other work after a termination. In this case, the Government removed the contractor from the Qualified Manufacturers List (QML), which meant that he was effectively barred from

using the equipment since his business involved exclusively military procurement contracts. Since there was no other work for the contractor to engage in, these costs were found to be allowable, reasonable, and allocable under ASPR 15-201, and not prohibited by ASPR 15-205.42(a). The board concluded that the allowability of a cost under ASPR 15-205.42(a) "is a subjective determination not an objective one."⁵⁴ Thus, this case demonstrates a fairly consistent phenomena in convenience termination settlement issues, the facts of a particular situation are of extreme importance in deciding the allowability of common item costs and the final determination may well be "subjective." The case also shows that "common items" can include more than just the raw materials of production; it can also encompass equipment idled by a termination.

This Cost Principle is a sensible one from a Government perspective since it obviates the need to pay a contractor for something he could use on his other work. Thus, it avoids a double recovery situation. A contractor can really only contest a denial of a claim by trying to show that the items are not reasonably usable on his other work. Thus far the decisional law has had little occasion to delineate what is "reasonably usable" and what constitutes a "loss" if the items are retained, but it has decided that costs incurred before the request for proposals is issued will not be protected and that common items include equipment used in production

and not just the material used to make up the end product. However, the claimant will have to be aware that he will be required to carry the burden of proof in showing that the claimed items are not reasonably usable on his other work or can only be retained at a loss.

C. Costs Continuing After Termination

ASPR 15-205.42(b):

(b) Costs Continuing After Termination. If in a particular case, despite all reasonable efforts by the contractor, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in this Part, except that any such costs continuing after termination due to the negligent or willful failure of the contractor to discontinue such costs shall be considered unallowable.

1. Allowability

One of the most important Termination Cost Principles for the contractor is the one which enables him to recover the costs which continue past the termination date and cannot be discontinued immediately through "reasonable efforts." This principle does not define which costs can be considered for allowability, although there is impliedly some limitation since it refers to "certain" costs which cannot be immediately terminated and states these costs are "generally" allowable within the "limitations" of Part 2 of Section XV of the ASPR. The only specific limitation is that any of these costs will be unallowable if they are due to the "negligent or willful failure of the contractor to discontinue such costs."

There are several issues left unresolved by the language of this Cost Principle. One is what to do if the plant or equipment giving rise to the costs was not acquired specifically for the performance of the contract, i.e., is this a factor which will determine the allowability of the claim? Baifield Industries,⁵⁵ indicates that this is a consideration which is not governing since "the cost principles applicable to continuing contract costs do not condition allowability upon the acquisition of facilities, etc., solely for performance of the terminated contract. The relationship which must be shown is a clear connection between the costs claimed and the terminated contract and, further, that those costs could not have been reasonably shut off upon the termination."⁵⁶

In the Baifield case the contractor was able to recoup the costs of disposing of a plant, inventory, and machinery associated with a contract since these items were not usable in other work of the contractor and could not reasonably be shut off at the point of termination. An important issue was how long a time these costs could be accumulated after the termination. The contracting officer only allowed costs up to what was the scheduled final completion date of the contract, 28 February 1970. The board determined that the "cost principles do not provide that such a date marks the expiration of the period for which continuing costs are recoverable."⁵⁷

The board allowed these costs, in particular the expenses in maintaining the plant for a period up to December 1970, since this was the time needed to locate a lessee. A finding was made that the contractor had made diligent efforts to dispose of the plant and equipment by inquiring of the local chamber of commerce and a local manufacturer, advertising in large regional newspapers and a national real estate journal, and had sought unsuccessfully to cancel his lease. The board further found the depressed state of the Texas economy at that time plus the nature of the plant and equipment made it difficult to effect disposition. Thus, the test of how long the contractor can expect to collect continuing costs is not limited by the expected date of the completion of the contract, but is based on a "rule of reason"⁵⁸ which must be supported by an adequate factual showing that the costs were discontinued at the earliest reasonable time. The board allowed recovery in this case even though the Government was able to point out that the contractor passed up opportunities to dispose of some items earlier than it did, for the ostensible reason that the contractor wanted to sell at a more favorable price; the board found that the contractor exercised "reasonable business judgement with regard to its disposition of termination inventory and equipment and the Government is not entitled to second guess that judgment."⁵⁹

Whether the standard is termed a "rule of reason" or a

rule of "reasonable business judgement," the focus on the question of allowability of continuing costs seems to be one of reasonableness. In the American Electric⁶⁰ case the contractor was able to recover the costs of plant insurance and taxes which continued on for nearly four years after the contract was terminated for convenience. The board found the costs were directly related to the terminated contract and were reasonable. In addition, the contractor was able to get telephone and utility costs. The utilities were necessary to control humidity and run the fire protection system, which was needed in order to keep the powder for the bomblet production from deterioration (the contract was for the production of cluster bomb units for use in Southeast Asia). The phone was necessary in clearing the inventory and as a condition of insurance protection. These costs were allowed to continue until the contractor's reasonably incurred efforts to dispose of the plant met with success four years later. A subcontractor was able to collect similar continuing costs in its settlement.⁶¹

2. Importance of Factual Proof

The R-D Mounts contractor⁶² was not as fortunate with his continuing cost claim, and it appeared the reason was founded on the fact that he was either unable or did not take the trouble to show that his utility costs were continuing costs. He simply made a claim for gas, telephone, water and power without in any way showing the time period for which these

costs were incurred or whether they had been allocated to any other contracts. The board therefore simply dismissed this claim as being unsupported by the evidence. Such a case demonstrates that unless the contractor is prepared to show clear evidence that such things as utilities are reasonable costs that can be identified specifically with the contract, the board will not only deny the claim but it may add, as it did here, that without this evidence it would appear these costs were probably parts of unallowable overhead which belong in an overhead pool for allocation to all work.

The former decision shows that where a contractor takes the time he can probably get the same type of cost allowed in his contract which is being denied in the latter contract. Indeed, with a proper factual showing, a contractor can overcome what may appear to be large obstacles. In the former case, the claim for utilities was made by the subcontractor despite the fact that he was on a twelve-month contract for utilities which, even when executed, stretched past the contemplated completion date of the contract. However, this was not a problem since the subcontractor was able to show a reasonable need for the utilities stretching past the termination date.⁶³ An examination of the case doesn't disclose that there is necessarily any challenge to showing that there is a reasonable need for utilities. The contractor did not appear to do much more than show that the utilities were useful for the heat and light they produced and that this would be

useful for a period of time to wind up the contract after termination. This time period turned out to coincide with the time it took the contractor to dispose of the building and equipment.

3. Unabsorbed Overhead

One of the recurring issues associated with continuing costs is whether or not a particular cost is allowable as a "continuing cost" or must be denied as "unabsorbed overhead." It has been stated as regards this subject that the issue of continuing costs is "one of the most complex and controversial considerations involved in negotiating contract termination settlements. The most difficult individual problem in this area has been the subject of unabsorbed overhead."⁶⁴

The concept of unabsorbed overhead basically involves a situation where overhead is not recovered from contract revenues because of the cessation of direct labor caused by the contract's termination.⁶⁵ Although the subject of unabsorbed overhead will recur in discussions later on, since it is relevant to several of the Termination Cost Principles, it is perhaps associated most closely with this cost principle.

The denial of unabsorbed overhead is a primary defensive weapon used by the Government to thwart a fairly common attempt by contractors to put as much of their overhead as possible after a termination into the allowable portion of termination costs. An example is the American Electric case

cited above where the electrical utilities claim was denied by the Termination Contracting Officer (TCO) on the ground that it was unabsorbed overhead. Such a decision might have been upheld on the ground that this represented a cost that would not be directly related to the termination of the contract; however, counsel furnished enough of a factual showing of the important purpose served by the utilities during the termination proceedings that the board found this was an allowable continuing cost and not unabsorbed overhead. It was because of this extensive presentation that the board disagreed with the TCO and DCAA auditor, who both felt that this period of electrical usage represented unabsorbed overhead, and sided with the contractor.

A test for deciding when continuing overhead may be allowable as a continuing cost was set forth in Chamberlain Manufacturing Corporation.⁶⁶ The test is that the claimed post-termination overhead costs must be either incurred as a result of the work performed on the contract or generated directly by the termination action.⁶⁷ In this case the contractor attempted to claim over \$150,000 worth of overhead which continued after the contract was terminated for convenience. The board decided that the contractor's "increased overhead rates do not constitute costs caused by or incidental to the termination and that its continuing overhead expenses are not continuing costs of the terminated contract."⁶⁸

The basis of this decision really rests, not in a

reading of the Termination for Convenience clause and the Continuing Cost Principle, but in previous board decisions on this subject, e.g., Technology Inc.⁶⁹ and Fairchild Stratos Corporation.⁷⁰ These decisions are all the more noteworthy since a reading of ASPR 15-205.42(b) would probably not enable one to strictly support this interpretation given by the board; the Termination Cost Principle on continuing costs does not in any way indicate which kinds of costs are to be determined as being allowable and which are not.

The term "unabsorbed overhead" is nowhere mentioned at all in the Cost Principles, but it is fairly certain that there now exists an unwritten "ASPR 15-205.42(h)" which states that unabsorbed overhead is per se unallowable, at least as long as a particular claim item is actually labeled as "unabsorbed overhead." This conclusion is subject to an asterisk, however, since a close reading of Technology Inc. indicates that with proper proof of overhead rates, some costs might be allowable,⁷¹ and Fairchild Stratos Corporation, a partial termination for convenience situation, where the amount of an equitable adjustment following the partial termination did allow for increased overhead.⁷²

The board in Technology Inc. was requested to grant an award for unabsorbed overhead as a continuing cost which extended for a time past the termination date. The board cited its Fairchild Stratos Corporation case and the Court

of Claims in Nolan Brothers, Inc.⁷³ in concluding that "the unabsorbed overhead which appellant is claiming here is likewise related to appellant's existence as an ongoing organization and not a continuing cost of the terminated contract."⁷⁴ In denying this claim, the board made it clear that it will not put the Government in the role of guarantor of the contractor's overhead. However, there is some equivocation as to the absoluteness of the denial of unabsorbed overhead in that the board states, "[e]ven if we were to determine that appellant is entitled to unabsorbed overhead as a continuing cost we would have difficulty finding for appellant on the record presented."⁷⁵

Thus a better factual showing could possibly have turned the decision around, but the board even then might have treated unabsorbed overhead with disfavor. However, the opinion can be helpful to a contractor who seeks to recover unabsorbed overhead since it did specify what type of evidence the board would consider suitable on such a claim. It indicated that the most persuasive presentation would be to come forward with evidence of what the actual overhead rates were which the contractor used in calculating the contract bid. These would be the rates used during the time when the contractor believed the contract would remain in effect.⁷⁶ Thus, it would appear that the board may allow unabsorbed overhead to be considered as a continuing cost if the claim is presented and supported by evidence showing the difference between overhead rates as used by the contractor when he was bidding on the contract and

the rates after termination.

When the contractor sought reconsideration of this case,⁷⁷ three cases were cited in which it was argued the board and the court had allowed the recovery of unabsorbed overhead.⁷⁸ However, the board distinguished these cases since they involved fixed overhead costs continuing after termination relating to facilities built or leased specifically for the terminated contract. Thus, these costs were considered to be continuing direct costs and not overhead; they were allowable since in each case a credible showing was made that these particular costs were really incurred specifically for the terminated contract. The board stated, "thus the cited cases hold that direct costs which continue for a reasonable time are includable in a termination settlement. They do not stand for the proposition that unabsorbed overhead is a continuing cost to be reimbursed as part of a termination for convenience settlement."⁷⁹

As a tentative conclusion, which can be modified through further decisional developments, unabsorbed overhead, even though the board has gone to some pains to develop what is essentially an unwritten prohibitory Cost Principle on the subject, can be recouped by the contractor. The technique for a successful continuing cost claim for unabsorbed overhead is first of all to never state that "unabsorbed overhead" is part of the claim. The next step is to make some factual showing that the cost item is incurred specifically for the

termination or for the contract. This may take some degree of hand waving, but the essential ingredient is to account for these costs as if they were direct costs, speak of them as if they were direct costs, and remind the board that in order to be made whole it will have to at least compensate these costs which continued on past the termination point of the contract. A contractor should take heart from the fact that other contractors have succeeded on exactly this basis, e.g., American Electric, where there was no question that rent and utilities were really overhead (even though the contractor only had the one Government contract being performed in that plant, the fact that both the utilities and rent contracts exceeded the contract term indicates that there was every intention that new work was to be forthcoming), and when there were no more direct labor dollars after the termination this became for more than four years unabsorbed overhead. Thus the board will really grant what is essentially unabsorbed overhead despite the fact this is never admitted. And to grant unabsorbed overhead, even under the guise of it being a direct cost, is in reality a step toward making the contractor whole.

In Chamberlain,⁸⁰ the contractor attempted to utilize the Government's instructions to preserve and store the termination inventory and tooling in order to argue that the overhead associated with this should be allowable after the termination as a continuing cost. This strategy did not work,

particularly since there was adequate evidence on the record to indicate that the contractor had been specifically compensated for complying with those requirements.

In discussing the subject of continuing costs, the board indicated that it feels the Continuing Cost Principle adequately describes the the types of costs which are allowable, "in thus circumscribing those continuing costs which are allowable, the regulation is neither unfair nor inequitable."⁸¹ As was pointed out earlier, not only does ASPR 15-205.42(b) fail to address the question of unabsorbed overhead, it also, very significantly for a contractor's claim does not even imply that the only allowable continuing costs are direct costs. In other words, it does not suggest by any part of its language that the only allowable costs under this principle are those which are directly related to the termination.

The language in ASPR 15-205.42(b) is broadly stated, i.e., it indicates that "costs" are "generally allowable." However, the board in Chamberlain asserted that if this Cost Principle was intended to cover unabsorbed overhead it wouldn't have used such broad language but would have been specific, i.e., "the continuation of overhead after a termination is a common occurrence and if the drafters of the regulation had intended to allow such costs they could have done so simply and clearly as they did for rental costs."⁸² However, in view of the general language of this Cost Principle,

it might be more logical to conclude that if unabsorbed overhead was not to be included it would have been clearly stated that it is unallowable.

A brief summary of the type of showing a contractor might be advised to present, after first insuring that his claim does not mention the term "unabsorbed overhead," if he intends to have some degree of opportunity to successfully claim unabsorbed overhead costs, would be to show that the increased overhead rates were caused by or incidental to the termination, that these costs are essentially direct costs, and that they were not recovered in new business.⁸³

4. Personal Services and Interest Charges

Contractors have tried to fit other types of charges into the continuing cost category, although perhaps with even less success than their attempts with unabsorbed overhead. Two examples are personal services and interest.

In the R-D Mounts⁸⁴ case, the contractor suffered a termination for default which was later converted to a termination for convenience. During the interim period the contractor claimed the salaries of its president and his wife for the work they had done in protecting the company from creditors and in trying to get the Government to reinstate the contract. The contractor argued that these were continuing costs under ASPR 15-205.6 and 15-205.42(b). The board, however, found that "[n]either of these provisions specifically allows the cost of personal services for work

performed after the contract has been terminated."⁸⁵ Only the cost of services which was relevant to winding up the contract would be allowable. The board found that the costs associated with trying to get the Government to reinstate the contract and efforts to obtain new work were not continuing costs.

This decision probably accords with the ASPR, but it does not seem to comport well with considerations of making the contractor whole as compensation for the exercise of the Government's right to terminate the contract. This does not particularly seem fair in a case such as this where the contractor had to fight to get the termination for default overturned. The board in an earlier decision⁸⁶ had found that the contractor was excused from a default termination of this contract since the Government had failed to make progress payments as it was required to do under the contract.

Thus, even though the Government's termination for default caused the contractor months of time, effort, and expense to overturn, the Government did not have to bear all of the consequences of its erroneous default decision since a termination for convenience will not compensate the contractor for his costs in seeking to overturn the final decision on appeal. In this particular case, the contract had been terminated for default approximately eleven months before it was converted to a termination for convenience; it would seem that as a matter of equity the Government's lack of a basis

to sustain the default termination should operate to allow the contractor the costs of his appeal, including the efforts of the president and his wife.

It would also appear that the board could find that this is a distinctly different situation from the case where a unilateral convenience termination settlement is appealed following a termination for convenience. This situation starts off with an erroneous termination for default which necessitates an appeal, assuming the contractor is financially able to assert his rights. The fact that the default termination is converted later to a termination for convenience does not in reality put the contractor back to where he would have been if the Government had not made its erroneous decision for default, since the contractor now enters the stage of negotiating a convenience termination settlement with the contracting officer having already accumulated a collection of appeal costs which he would not have incurred had the contract been originally terminated for convenience. These costs do deserve special treatment because they were incurred to overturn what has been decided by the agency head's representative (the board) to be an erroneous decision on the part of that agency.

Although there is no one specific Termination Cost Principle which deals with the costs incurred to overturn a default termination, the Continuing Cost Principle could easily be read, because of its general language, to grant

relief to the contractor. To deny compensation in such a case assumes that the contractor enters into a Government contract assuming the risk of not only the consequences of a termination for convenience and a termination for default, but also an erroneous termination for default. The latter risk is neither mentioned nor bargained for, and should not be a risk of federal procurement. It would seem that we are well past the day when not only does the sovereign regard himself as error free, but also judgment proof. There is language which is applicable to this situation in the Continuing Cost Principle, and it should be applied to the contractor in order to make him whole.

Although an equitable argument could also be made for allowing interest as a cost, relief is much more difficult in this area since interest is no longer allowed as a continuing contract cost by the ASPR. There are some older cases where interest was allowed as essentially a continuing cost,⁸⁷ but these cases are now little more than relics of the past. An example of a recent case dealing with the question of interest is Southland Manufacturing Corporation,⁸⁸ where the contractor attempted to collect interest on borrowings it had accomplished with a commercial bank and the Small Business Administration.

The argument made by the contractor was that ASPR 15-205.42(b) would allow interest payments, but the board stated that these payments would not be allowed since this Cost Principle must be read in conjunction with ASPR 15-205.17,

which specifically prohibits interest on borrowings. The phrase in ASPR 15-205.42(b) which was interpreted as bringing into action ASPR 15-205.17 was the clause "within the limitations set forth in this Part." Since ASPR 15-205.17 is also included in Part 2 of Section XV of ASPR, it must be complied with, and it states that "interest on borrowings (however represented) . . . costs of financing and refinancing operations . . . are unallowable except for interest assessed by State or local taxing authorities under the conditions set forth in 15-205.41."

In sum, the Continuing Cost Principle (ASPR 15-205.42(b)) is perhaps one of the potentially most useful aids to making a contractor whole. Particularly in the areas of unabsorbed overhead and appeal costs for a successful conversion of a default termination, there is adequate reason to argue that this principle should and must apply if the contractor is to be made whole.

D. Initial Costs

ASPR 15-205.42(c):

(c) Initial costs, including starting load and preparatory costs, are allowable, subject to the following:

(1) Starting load costs are costs of a nonrecurring nature arising in the early stages of production and not fully absorbed because of the termination. Such costs may include the cost of labor and material, and related overhead attributable to such factors as--

- (i) excessive spoilage from inexperienced labor,
- (ii) idle time and subnormal production occasioned by testing and changing methods of processing.
- (iii) employee training, and
- (iv) unfamiliarity or lack of experience with the

product, materials, manufacturing processes and techniques.

(2) Preparatory costs are costs incurred in preparing to perform the terminated contract, including costs of initial plant rearrangement and alterations, management and personnel organization, production planning and similar activities, but excluding special machinery and equipment and starting load costs.

(3) If initial costs are claimed and have not been segregated on the contractor's books, segregation for settlement purposes shall be made from cost reports and schedules which reflect the high unit cost incurred during the early stages of the contract.

(4) When the settlement proposal is on the inventory basis, initial costs should normally be allocated on the basis of total end items called for by the contract immediately prior to termination; however, if the contract includes end items of a diverse nature, some other equitable basis may be used, such as machine or labor hours.

(5) When initial costs are included in the settlement proposal as a direct charge, such costs shall not also be included in overhead.

(6) Initial costs attributable to only one contract shall not be allocated to other contracts.

The allowability of initial costs is specifically mentioned in the Termination for Convenience clause, paragraph (c)(ii)(A), which provides for the recovery of starting load and preparatory costs under certain circumstances. Starting load costs are nonrecurring costs which arise early in production and are not fully absorbed by virtue of the termination. Preparatory costs are those incurred in preparing to perform the contract which do not include starting load, special machinery, and equipment costs.

1. Precontract Costs

Upon reading ASPR 15-205.42(c), one question concerning allowability may remain and that is, when must the cost be incurred to be allowable? In Codex Corporation,⁸⁹ the

contractor attempted to recover his costs in producing inventory more than a year before he was even awarded the firm fixed price contract. The contractor incurred these costs because the Air Force had expressed interest in his product; however, these costs were incurred seven months before the request for proposals and more than a year before award of the contract. These costs were disallowed in the convenience termination settlement and represented about 98 percent of his total claim of over \$78,000.

If the contract had been performed, these costs would probably have been recovered since the contract price would have included an amount to cover these pre-contract costs. However, when the contract was terminated for convenience, the termination settlement had to be based on Section XV of ASPR and the Termination for Convenience clause of the contract; thus, the contractor could receive the contract price only on the items completed.

In this case the contractor attempted to fit his pre-contract costs under subparagraph (e)(ii) of the Termination for Convenience clause, which mentions the allowability of initial and preparatory expense allocable to the contract. Neither of these two terms, "initial cost" nor "preparatory expense," is defined in subparagraph (e)(ii) as to any limitations concerning when these costs must be incurred. Although ASPR 15-205.42(c) does define these terms, it is not specific on this question either.

However, the board found guidance in ASPR 15-205.30,⁹⁰ which deals with pre-contract costs, since it appears to exclude any costs incurred prior to the award of the contract. Thus, when this provision is read in conjunction with ASPR 15-205.42(c), the contractor finds that in reality he is not able to be paid for what he may have believed the Termination for Convenience clause promised him, i.e., "the costs incurred in the performance of the work terminated, including initial costs and preparatory expenses allocable thereto."

When this claim was disallowed, the contractor quite probably suffered a substantial loss since upon termination the market value of the inventory produced before the request for proposals fell to scrap value, since there was no other Government or commercial market. This result is not necessarily fair, particularly since it is hard to believe that the Government didn't receive some advantage from a situation where a contractor has a supply of contract inventory already on hand. This could result in a lower negotiated or bid price, more efficient delivery and timely performance, and more experience on the part of the contractor. In this case, the deliveries were to be commenced within 60 days of the date of award and completed within 120 days of award; although the board does not disagree with the argument that the contract delivery schedule could not have been met absent this pre-contract work, it decided that since the costs were

not actually incurred in order to be able to meet the contract requirements, the costs were unallowable.⁹¹

This point should not be determinative. After award this inventory was transferred to the contract;⁹² it would seem that at this point the inventory could be charged to the contract and gain the benefit of the Termination Cost Principles. Previous to the award and transfer it was a cost borne by the contractor, but after award the contractor could have produced more inventory to charge to the contract; instead, he chose to utilize what was already produced. The point is that the contract should have incurred a cost (as opposed to the contractor) no matter how the inventory happened to originate. Therefore, it shouldn't really make any difference in treatment since at the time of termination, this was contract inventory.

The contractor did recover something for the expenses of storage and insurance of the inventory, mainly on the basis that the amount claimed was small (\$394.00) and would not have been incurred but for the termination. This cost is allowable under ASPR 15-205.42(f)(2) as the "reasonable cost for the storage . . . of property acquired or produced for the contract." Thus, the board finds on the one hand that the cost of storage is allowable since the inventory was acquired for the contract, but it won't pay the costs incurred to produce the inventory because "it was not produced or acquired in connection with the performance of the work

terminated within the meaning of the termination for convenience article."⁹³ Thus, this same property gets two different treatments; it is considered sometimes as part of the contract inventory and sometimes not, but the result is that the contractor is not made whole.

Perhaps the only way to circumvent this result, and it may not be an uncommon problem that a contractor has spent a great deal of his own money in a Codex Corporation type of situation, is to try and get the Government to specifically allow in the contract that it waives any prohibition against the allowability of certain specified costs incurred before contract award in the event of a termination for convenience. The contractor would be ill-advised to attempt later to fit pre-contract costs under ASPR 15-205.42(c) since it is probably certain that the board will not allow the costs incurred before the request for proposals was issued.

Some accountants may disagree with the board's decision, since it has been argued that "any cost incurred prior to performance if incurred for the benefit of the terminated contract is an initial cost regardless of how treated by the contractor when recorded. It is the benefit, not the recording that controls."⁹⁴ Although this does not necessarily stand for the proposition that pre-solicitation costs should be recoverable, it is not an illogical extension to conclude that since these costs were later allocated to production this fact should control and not the unfortuitous circumstance for the contractor that the costs happened to be incurred before

solicitation. In any event, this line of reasoning will most likely not prevail, and thus the contractor should protect his pre-solicitation costs by attempting to either be paid a higher price for the initial contract items or be allowed to provide specifically for the favorable treatment of these costs in the contract, in the event of a termination.

2. Preparatory and Starting Load Costs

An example of a case involving preparatory costs is Baifield Industries,⁹⁵ which involved a claim for the costs of improvements which were made in getting a plant ready for production. There was no dispute by the Government as to the fact that the improvements were reasonably necessary for performance of the contract and were made in reasonable amounts.

These costs were expended for such things as altering the plant by installing additional pipe and completing some concrete work and rest room improvements, as well as adding an additional railroad spur (which the contractor had earlier represented as not necessary). The board allowed these costs and indicated that there was no evidence these costs should be unallowable, particularly since recovery was provided for under the Termination for Convenience clause.

However, the contractor does not always have such an easy time before the board with a claim for preparatory costs. For example, when a contract has a first article approval clause which requires that the contractor have Government

approval of test samples before the Government becomes liable for costs incurred for production, special care must be taken to comply with that clause. Failure to get the first article approval, even where there is a threatened national railroad strike which induces the contractor to order production materials early, can result in denial of a claim.⁹⁶ The board found in that case that there was neither waiver of the clause nor impossibility of complying with the delivery schedule, as was the case in Young Metal Products.⁹⁷ Thus, the contractor should be aware that initial costs can be limited by a first article approval clause, and that unless there exists a situation where it would be impossible to comply with the delivery schedule unless the order is made in advance, these costs will not be allowed.

"Preparatory costs" is sometimes used interchangeably with "starting load costs," even though they are technically somewhat different terms. In the Collins Electronics⁹⁸ case, the cost expended by a contractor in familiarizing himself with Government specifications and Government requirements to provide data on the contract end products was termed a "preparatory" cost.⁹⁹ In that case the contractor was able to recover these costs despite the fact that he was required to supply the same end product on a previous contract; but in the previous contract he did not become familiar with the specifications since he had subcontracted out the work on that item. Thus, the board allowed some of the costs of preparatory

work, which was really familiarization by the contractor's engineer, but not all the claimed costs were allowed since the engineer did not keep any daily time records and had to testify from memory. The definition of "starting load" costs under ASPR 15-205.42(c)(1)(iv) would seem to apply to the allowability of familiarization costs somewhat better since it includes factors concerning the "unfamiliarity or lack of experience with the product, materials, manufacturing processes and techniques," but the result would still be the same.

This case is instructive on a considerably more useful point and that is that the board will expect a claim for initial costs to be buttressed by written records, rather than just testimony from memory. This may not always be as convenient a situation to make allowances for as it seems. This case, involving an engineer examining specifications and data requirements levied by the Government, probably involved the incurrence of costs well before a termination for convenience was even considered by the Government and is not the type of cost a contractor would then consider as requiring accurate and complete documentary proof. But it does teach that it would be wise to be documenting performance for purposes of termination even during the time one is trying to prepare for contract performance. It may seem somewhat unrealistic for the contractor to have to impose a reporting function at that time on his personnel so that some degree of written proof will be available as to their time spent, but

this is nevertheless a critical concern when a contractor is trying to collect money from the Government after a termination. This policy of preparedness is wise despite the policy expressed in the ASPR:

(c) Cost and accounting data may provide guides, but are not rigid measures, for ascertaining fair compensation. In appropriate cases, costs may be estimated, differences compromised, and doubtful questions settled, by agreement. Other types of data, criteria, or standards may furnish equally reliable guides to fair compensation. The amount of record keeping, reporting and accounting, in connection with the settlement of termination claims shall be kept to the minimum compatible with the reasonable protection of the public interest.¹⁰⁰

A review of the convenience termination settlement cases demonstrates the advisability of relying on hard data and written proof rather than the argument that this is not available since it would have entailed too much record keeping.

This particular contract was a competitive fixed price supply contract. The contractor's entire orientation would not have been on keeping detailed cost records since he is compensated on the basis of contract completion and delivery of contract end items. The surprise to a contractor, at least one with little experience in Government contracts, is that the termination of the fixed price contract really means that he is realistically converted to a cost reimbursement situation for the costs incurred prior to the termination and those allowable post-termination costs. Records of costs are now for the first time very important to the contractor; without them he may find his claim cut 75 percent, as it was in Collins Electronics,¹⁰¹ involving an experienced Government

contractor. Documentation will not guarantee that a claim will be allowed, but it could very well be instrumental in protecting an investment in such things as preparatory costs; also, an effort at organized record keeping should assist the contractor in negotiating with the TCO.

The ASBCA is perhaps more precise, or at least more inclined to cite specific regulatory or contract provisions when it analyzes convenience termination settlements, than are some of the other Boards of Contract Appeals. The Department of Transportation Board had occasion to consider preparatory costs in Building Maintenance Specialists,¹⁰² where the issue was whether or not the contractor was entitled to the set-up costs for moving equipment and materials to the site, as well as recruiting workers. The board did not cite any provision of the Federal Procurement Regulation,¹⁰³ but did cite the Christian¹⁰⁴ case and Bateson Construction Co. v. United States¹⁰⁵ for the proposition that costs incurred in performing work prior to termination are recoverable since they are an "integral" part of the contract work.

This type of test would not involve such questions as whether or not these costs might not have already been included in the settlement proposal as direct charges, or perhaps even allocated in part to other contracts. However, these possibilities are accounted for in both ASPR 15-205.42(c)(5) and (6), and FPR 1-15.205-42(c)(5) and (6), which indicate the value of a detailed examination of not just the decisional law

but also the regulations, as well.

Preparatory costs were at issue in American Packers,¹⁰⁶ where the contractor was able to recover the costs of such things as stationery and office supplies purchased in advance and necessary for work during the contract period, vehicle insurance, license fees, uniforms, and building repair requested by the contracting officer. The contractor used the inventory basis for submitting his claim, although he had first attempted to make his submission on the total cost basis.

The inventory basis is the "preferred" basis for a termination settlement proposal.¹⁰⁷ Under this method only the costs allocable to the terminated part of the contract are claimed. The completed and accepted end items are separately stated and are paid at the contract price. Another method of presenting a settlement proposal is the total cost basis,¹⁰⁸ under which all costs are claimed, even the costs which are applicable to the completed end items, then the contract price of all the completed and accepted items is deducted. This method can only be used with the contracting officer's consent; however, it is theoretically supposed to give the same result.¹⁰⁹

The difficulty the contractor sometimes has in proceeding along the "preferred" inventory basis route is that he cannot properly allocate such things as his initial, labor, and overhead costs since not all of these costs will probably be allocable to the terminated part of the contract. Starting

load costs are often not segregated by the contractor's accounting system; thus, these costs must be identified and discounted in an inventory basis claim, whereas if the total cost basis were used this would not present a problem.¹¹⁰

In resolving this termination for convenience settlement case, the board did not cite any of the ASPR Termination Cost Principles. Perhaps the contractor would have benefited if these principles were discussed since ASPR 15-205.42(c) indicates that when the inventory basis is used in presenting the settlement proposal, "initial costs should normally be allocated on the basis of total end items called for by the contract immediately before termination" The contractor did not recover any expense for vehicle acquisition, and perhaps he should have recovered an allocable share of their acquisition cost if he had argued this was an initial contract cost.

The inventory and total cost basis do not always result in identical claims. In ITT Defense Communications Division,¹¹¹ the contractor's first claim was submitted on the inventory basis and was for over \$309,000; his revised claim was for over \$245,000 and was on the total cost basis. But the case is remarkable for the factual basis of its award of preparatory costs. The contractor was to supply data processing equipment but could not be paid until the equipment was successfully demonstrated. Before successful demonstration, the termination for convenience occurred; the contractor sought to recover his

preparatory costs, but the Government attempted to argue that the successful demonstration clause barred any payment for these costs. The board decided that it would be "unreasonable and unconscionable" under Section 2-302, Uniform Commercial Code, to conclude that the clause barred payment and that the contractor accepted the risk of this in the event of a termination.¹¹² Thus, the claim to install the data processing equipment was payable for preparation costs despite the fact the installed system was so far from being acceptable that the test period was terminated after only three days, and despite the fact only a short-form Termination for Convenience clause was used.¹¹³

A case which may appear similar to the ITT case is Precision Switch Corporation,¹¹⁴ in which the contract had a first article approval clause. The contractor was not supposed to incur any costs in acquiring materials for further production or actual production of additional units until the first article was approved. When he went ahead and acquired further materials and even completed production after award but before first article approval, his claim for over \$16,000 was unilaterally settled and upheld for \$128.50, the cost of producing the first article. This is a different case from ITT since there the contractor was only claiming the costs associated with preparing a unit for demonstration, thus no costs were claimed for production of the contract quantity after the test period.

3. Allocation After a Partial Termination

An example of a problem which arises when there is a partial termination for convenience is the allocation of initial costs which are associated with the terminated part of the contract. In Sternberger v. United States,¹¹⁵ the Court of Claims was asked, in part, to determine the amount of an equitable adjustment to be made after the spare parts portion of a contract was terminated for convenience. The board found that the contractor had incurred costs of a certain amount in preparation for the entire contract and multiplied this by 28.342 percent, which represented the percentage of the total contract price of the portion terminated. This was to give the amount allocable to spare parts.

The contractor was in disagreement with this formula since he felt that the termination for convenience clause required the award of an overall increase in the cost of the non-terminated part of the contract. However, in this case the terminated part of the contract had not been performed yet at all, and the board's method of allocation was considered correct. The Court of Claims concluded that "the preparatory nonabsorbed costs with respect to the terminated portion, not absorbed by the non-terminated portion, thereby became allowable at a lump sum, without any need for their distribution among the completed finished products."¹¹⁶

This percentage method of allocating preparation costs is more in the nature of a jury verdict approach since there

is nothing to indicate that this is other than an approximation. The underlying premise is that the two parts of the contract, the terminated and the unterminated part, each incurred preparation charges at the same rate. This may not always be accurate, and such a method may not always be in the contractor's best interest. Should a contractor suffer a partial termination for convenience, he would probably want to recover immediately as much of his costs as possible through the settlement. Thus, it might be advisable for him to keep records of preparation costs so that if the percentage method is not favorable, he can present some evidence as to how much was spent preparing the terminated part of the contract.

The resort to what appears to be really a jury verdict method is somewhat surprising in view of the fact that the court states explicitly earlier in the opinion that "both 'jury verdict' and 'total cost' standards are not favored."¹¹⁷ But since it appears the contractor did not have sufficient records to otherwise support his claim, the court did not upset the board's findings.

4. Overhead

Unabsorbed overhead is sometimes included as part of the claim for initial costs. In Meyerstein v. United States,¹¹⁸ which is a case arising out of a World War II contract and thus before the passage of the Armed Services Procurement Act, a contractor was supposed to get a certain

hourly fee, representing a charge for overhead, in addition to an hourly labor rate for repairing jeeps. The contract was terminated for convenience after about one-half the contract had been completed, and the contractor attempted to collect the hourly fee for overhead of the terminated part of the contract by arguing that these costs were initial costs allocable to the terminated part of the contract. The contract did allow the recovery of initial costs, which were defined in the "Statement of Cost Principles," and summarized by the Court of Claims as being "costs of a nonrecurring nature which arise from unfamiliarity with the product in the initial stages of production."¹¹⁹

The contractor lost this claim because he could not present any evidence to show that the hourly overhead fee was meant to recover costs of a nonrecurring nature. Thus, a contractor should perhaps be aware of the fact that since he will plan to recover overhead charges over the life of the contract, it would be worthwhile to see if the Government will allow him to specify what part of these charges represent initial costs. Then, if a termination for convenience should occur, his burden of proof in proving initial costs will be easier in view of the fact there is a consensus as to which costs are relevant for this calculation. In Meyerstein, it is somewhat difficult to believe that the contractor did not have some initial costs; he asserted he had expenses arising from unfamiliarity with the product, training expenses, and

in setting up the assembly line. However, since no evidence was presented as to whether or not the hourly charge was intended to cover initial costs, he was not able to collect any charge at all for the terminated hours of the contract.

Initial cost principles have also been applied to unamortized labor learning expenses. In Continental Electronics Manufacturing Company,¹²⁰ a multi-year contract was terminated for convenience before the start of its last year. The contractor attempted to recover the higher labor costs he had incurred in producing the first production units; these costs would have been recovered in the prices of the cancelled items. The labor costs at issue were developed by the use of a labor learning curve. The theory of the learning curve is that each time the quantity of production doubles, the labor cost of the last units of production will be lower than the previous units of production by the percentage figure that represents the learning curve.¹²¹

In this case the contractor calculated his learning curve at 80 percent on the terminated units. Thus, the contractor began the computation of his claim by calculating the actual labor cost of the units delivered, and by taking 80 percent of this, he arrived at the labor costs for the terminated portion. Adding these two labor cost figures, i.e., the actual labor cost and the labor costs for the terminated portion, and dividing by the number of units terminated, gave the average unit cost of all units that had

been produced. This figure could then be subtracted from the actual labor cost to get the difference representing the excess labor cost of the delivered units, i.e., unamortized learning expenses.

The reason for the learning curve is that labor becomes more efficient as it becomes familiar with and learns how to better utilize its tools and equipment, as supervision improves, and as efficiency is gained through repetitive accomplishment of the same tasks. In the case at hand, the contracting officer had disallowed these costs, and the Government auditor who testified before the board did not feel that "learning costs" were included within the meaning of "initial costs." But the board, after examining ASPR 15-205.42(c) for guidance on initial costs, concluded that the language of ASPR 15-205.42(c)(3), i.e., the costs "which reflect the high unit cost incurred during the early stages of [the] contract," is a specific reference to the allowability of learning costs as an item of initial costs, i.e., that "early high labor costs fall squarely within that definition."¹²³

The board also found that simply because some of the claimed costs were not specifically stated in ASPR 1-322.1(c), dealing with multiple-year procurement, this would not be conclusive as to the types of costs which are allowable since this provision is only meant to be illustrative.

In sum, one of the most substantial challenges to meet in order to be made whole for the incurrence of initial costs

is the necessity of being properly prepared to make a well-supported claim for unabsorbed overhead. One method is to attempt to work out an agreement on allowability when the contract is negotiated; if this is not productive, the contractor should attempt to keep adequate records of initial costs which will then support a learning curve analysis.

E. Loss of Useful Value

ASPR 15-205.42(d):

- (d) Loss of useful value of special tooling, special machinery and equipment is generally allowable provided--
- (i) such special tooling, machinery or equipment is not reasonably capable of use in the other work of the contractor;
 - (ii) the interest of the Government is protected by transfer of title or by other means deemed appropriate by the contracting officer; and
 - (iii) the loss of useful value as to any one terminated contract is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the contract bears to the entire terminated contract and other Government contracts for which the special tooling, special machinery and equipment was acquired.

The right to be compensated for the loss of useful value of special tooling, special machinery and equipment is not mentioned specifically in the Termination for Convenience clause of the contract. It is, however, an important component of the rights a contractor should consider when he is composing his termination claim. Any loss of useful value suffered when the contract is performed, rather than terminated, would normally be recouped through the contract price as the contract is performed. But since

the contract has been terminated, these costs are no longer amortizable against the contract price over the remainder of the work.

Thus, it can be quite useful for a contractor to know how the loss of useful value of tooling, special machinery and equipment can be recovered after a termination. This is perhaps an abnormal consideration for the contractor since if the contract were performed he would only be concerned with recovering the contract price, and therefore his accounting system may not be geared to identifying these types of costs. However, he should be aware of the need for furnishing data which would support such a claim.

This Cost Principle is thus consistent with resolving the problem expressed in the first paragraph of ASPR 15-205.42, "[c]ontract terminations generally give rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the contract not been terminated." Without the existence of this particular cost principle, the contractor in many situations could not be "made whole" for the consequences of the termination.

1. When Is the Cost Allowable?

One aspect of allowability which is not discussed or mentioned in this Cost Principle is the question of when the cost must be incurred to be allowable. Also, there is no mention of for how long a time past the termination such a loss might be compensated.

The first of these two questions is answered by a case such as R-D Mounts,¹²³ where the contractor made a claim for special tooling after the termination for default had been converted to a termination for convenience. Some of the tool items had been purchased and invoices were available; other items were made in-house. However, all of the tooling had been acquired before this particular contract had been awarded, although it had been acquired and used on a prior contract to make the same item.

The Government auditor questioned this claim on the issue of proof, such as the fact that there was no special tooling account in the contractor's books and there were no records of the cost of the items of tooling. But he was also indisposed towards the claim since the tooling was purchased before the award of the contract.

The board indicated that there are two ASPR provisions which treat this subject, ASPR 15-205.40(c) and 15-205.42(d). Although there was no explanation as to how these provisions relate to each other, it seems likely that ASPR 15-205.40(c) was meant to set forth the primary guidance in most contract situations on the allowability of costs for special tooling and special test equipment; ASPR 15-205.42(d), while consistent with this, should have been designed to set forth the particular rule which applies to special tooling and special test equipment in convenience termination situations.

The board pointed to paragraph (c)(i) of ASPR 15-205.40(c) for the rejection of the contractor's claim, since this is the provision which clearly points out that tooling which is acquired before the effective date of the contract is not allowable, except as depreciation or amortization. The board recognized that the treatment under ASPR 15-205.42(d) is "similar although not identical, in import to section 15-204.40(c) [sic],"¹²⁴ since it would allow recovery of loss of useful value in a ratio equivalent to the proportion the terminated contract bears to other contracts for which the tooling was acquired. And the board notes that ASPR 15-205.42 is designed to give special treatment to costs that are present because of the termination.

Yet, the board decided that ASPR 15-205.40(c)(i) supersedes the Termination Cost Principle, ASPR 15-205.42(d), in a termination situation and thus could not approve this claim. By so deciding, there is again a failure to make the contractor whole for the exercise of the Government's power to terminate for convenience. Thus, the contractor did not recover the portion of his claim for loss of value of special tooling which should have been recoverable "in the same ratio as the terminated contract bears to the other contracts for which the

tooling was acquired."¹²⁵

While ASPR 15-205.42(d) does not state that an item must not be acquired prior to the effective date of the contract, this is perhaps not an unreasonable requirement. But yet it would also not be unreasonable to allow such a cost as was claimed here, and not take advantage again of the fortuitous event that the tools were purchased early; such a result would comport more consistently with the principle of making the contractor whole and give him the benefit of "special treatment of costs" promised by ASPR 15-205.42, paragraph one.

This case represents an example of the use of the non-termination cost principles of ASPR Section XV, Part 2 being used to limit the application of the fairly broadly stated Termination Cost Principles; the result is that the distinction between the ASPR 15-205.42 Termination Cost Principles, which are designed to give "special treatment to costs," and the other cost principles are blurred. The board continues to insist that should there be a conflict, these other cost principles prevail.

This is not necessarily what the drafters of ASPR

15-205.42 had in mind when they directed that the remainder of Part 2 was to be used in conjunction with the Termination Cost Principles. This could just as logically have been interpreted to mean that the other cost principles are to be used when a matter is not covered by the Termination Cost Principles, but that when it is, the Termination Cost Principles govern in order to follow the guideline that special treatment is required since "[c]ontract terminations generally give rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the contract not been terminated."126

What is perhaps equally troublesome is that the board in this case did not appear to be particularly consistent in its interpretation of ASPR 205.40(c) in that it allowed the contractor some amount of compensation for two of his tool items for the wrong reason. Both of these tools were acquired for use on a previous contract and both were later modified for the performance of the contract at issue in this case. The board allowed the cost of these modifications despite the fact that there seems to be no possibility this could ever be allowable under ASPR 15-205.40(c) since the items were acquired prior to the effective date of the contract; this cost principle plainly states that it does not allow the costs of "items acquired by the contractor prior to the effective date of the contract whether or not altered or adapted for use in the performance of the

contract."¹²⁷

In Pamco Corporation,¹²⁸ the other side of the coin is presented since the issue here involved equipment leased for a period of time which extended past the contract completion date. The contractor had entered into a lease for forging machinery when the contract had ten months to run, and one contract for the lease of hydraulic presses and pumps when the contract had nine months to run. Both leases were for a period of fifteen months and contained no termination for conveniences provision. The Government argued that the Korean War was about over and it was clear the prime contract might prove unnecessary; but the contractor was able to show the Government had warned the contractor to keep meeting schedules and had indicated there were plans to stretch out the contract. The Government did furnish a new delivery schedule which added six months to the planned contract, but this was not given to the contractor until after both leases were signed. The cost principles of Section VIII, Part 4 of ASPR applied then, and contained a clause substantially similar to the present ASPR 15-205.42(d).

The board felt the decision to lease the equipment should be viewed from the time the leases were made and should be considered also in relation to the Termination for Default clause since the contractor had a continuing obligation to perform the contract. The board stated, "we believe that contracts are entered into with the contemplation

that they will be performed, not terminated, and that contractors' actions should be taken with a view toward performance at a reasonable cost rather than toward termination."¹²⁹ Thus, it concluded that the contractor was reasonable in leasing the equipment, and it made no difference he was unsuccessful in terminating the leases after termination. As the board stated, "in order to perform a contract a contractor on occasion will acquire--by lease or purchase--something reasonably necessary if the contract is to be performed but of little or no use if the contract is terminated."¹³⁰

The contractor was therefore allowed to recover the full amount of the lease payments past the termination for convenience point. This case does not definitely indicate that a contractor can recover lease costs past the contract's final completion date, since the delivery schedule here had been extended before the termination so that it overlapped with the end of the lease term. However, the board did not indicate that this fact was even considered. The standard the board used was whether or not the fifteen-month term was "reasonable," and they looked at reasonableness as it appeared at the time the leases were executed.

2. Special Tooling and Special Equipment

Another issue of concern in relation to ASPR 15-205.42(d) is the meaning of "special tooling" and "special machinery

and equipment." These two terms are defined in ASPR 15-205.40 and ASPR 8-101.21, respectively. This latter ASPR provision encompasses a severe standard for allowability since it requires that its purchase be "solely" for the terminated contract, or that contract and other Government contracts, and must be claimed to have lost its useful value in order to be "special."¹³¹ Thus, in order to be allowable under ASPR 15-205.42(d), "special" machinery and equipment should meet the ASPR 8-101.21 test that requires it be acquired solely for the performance of the terminated contract, in addition to the ASPR 15-205.42(d) requirement of showing a loss of useful value. The unique character of the facilities or their unusual nature is not enough to make an item "special."

There are several hurdles to meet before loss of useful value under ASPR 15-205.42(d) is shown. The board requires first of all a finding that the costs be reasonably incurred.¹³² Secondly, assuming the hurdle of being "special" has been met, the next requirement for allowability under ASPR 15-205.42(d) is to meet the three conditions specified in that cost principle, i.e., first, that the item not be reasonably useable in the contractor's other work; second, that the Government's interest be protected either by obtaining title or other appropriate means; and third, that double recovery be guarded against if there is more than one Government contract on which the item can be used.

The first test can be met despite the fact that another contractor is able to use the items in his work. In American Electric, the Government attempted to show that some equipment was not "special" since it was being used by another contractor. The board emphasized that this cost principle is not concerned with what other contractors could do, but only with whether or not the item could be used by this contractor in his other work.¹³³ This cost principle has even been used where an item was used in a minor way on another contract.¹³⁴

The second test can be met if the Government takes the equipment or directs its sale with credit given for the proceeds of the sale. The third test will not be relevant, as an obstacle, unless there is more than one Government contract on which the item can be used.

The DCAA auditor in American Electric did not want to allow machinery and equipment under the loss of value cost principle unless these items were first charged before termination as a direct cost. The board disagreed with this assertion since the ASPR definition of special machinery and equipment does not require this. The board also cited Professor Wright for the proposition that even though items may be capital assets for contract negotiation purposes, they must be treated differently in a termination and allowed to be charged to the contract.¹³⁵ This is because after the termination, the contractor is unable to do what he would

normally do to a capital asset, i.e., depreciate it over the period of its useful life, since the asset after termination has lost its value of being able to help produce additional contract revenue. And, as has been stated, "depreciation for idle facilities and write off for loss of useful value are separate accounting concepts. Depreciation is an allocation of cost over a period of time, whereas loss of useful value is an instantaneous decrease and is not considered depreciation for idle facilities."¹³⁶

Counsel in American Electric raised an issue as to whether costs arising from unexpired leases of real estate should be treated under ASPR 15-205.42(d) as a loss of useful value claim. Since the board did not have to answer this question to resolve the case, it did not express an opinion except to indicate some doubt as to the validity of using ASPR 15-205.42(d) when ASPR 15-205.42(e) is available.¹³⁷

However, the term "special machinery and equipment" has been stretched broadly enough to include physical "facilities" in a case¹³⁸ where it was found that the buildings were built to house production on the contract and after termination were not needed for other work. The board made a General Finding of Fact that the buildings contained features not found in other buildings and this was required by the contract; thus it concluded the facilities, as well as the equipment used, were "special machinery and equipment" and the loss of their useful value could be claimed.

One important advantage of a termination for convenience decision initially made by the contracting officer, as opposed to a termination for default which is later converted to a termination for convenience, is that compensation for idled equipment during the time it takes for the termination to be converted may not be compensated as easily. In K & M Construction,¹³⁹ a Corps of Engineers Board of Contract Appeals case, the contract had a provision indicating costs would be governed by Section XV of the ASPR. One item of this claim was for depreciation on tools and equipment idled during a period of approximately 4 and one-half years between the termination for default until the conversion to a termination for convenience. The board indicated, without further elaboration, that "this is a claim for consequential damages over which the board has no jurisdiction and which it cannot allow in any amount even though it has no doubt that Appellant's equipment was idled from October 1968 until April 1973 as a consequence of the Government's wrongful termination."¹⁴⁰

Although the contractor should have phrased and structured his claim as a loss of useful value, and not depreciation, the board did not help matters either since it does not even mention ASPR 15-205.42. It is possible that this Termination Cost Principle was overlooked by the

contractor in asserting his claim, since if he had argued along those lines, even slightly, the board could have noted that most of the Termination Cost Principles really compensate "consequential" type damages. Thus, the use of the label "consequential" should not be enough to deny the contractor's claim for compensation. The result of this case is that not only was the contractor not made whole for what likely was an allowable claim, but the Government wins in the worst of all situations, where it has been caught in error in terminating for default, yet does not have to pay for the consequences of the erroneous termination during the time taken to effect a conversion.

3. Special Tooling Versus General Purpose Tooling

In Southland Manufacturing Corporation,¹⁴¹ the Government, in a motion for reconsideration, contested the board's treatment of tooling as general purpose capital assets, rather than as special tooling. The contractor had never considered these tools to be special tooling but had instead always treated them as capital assets and had depreciated them. The Government argued that the Loss of Useful Value Cost Principle, ASPR 15-205.42(d), is only relevant to special tooling and not general purpose capital assets.

The board noted¹⁴² that ASPR 15-204(d), dealing with the application of the cost principles, should be given weight since it provides:

Failure to treat any item of cost in 15-205 is not intended to imply that it is either allowable or unallowable. With respect to all items, whether or not specifically covered, determination of allowability shall be based on the principles and standards set forth in this Part and, where appropriate, the treatment of similar or related selected items.

Thus, the conclusion was that the loss of useful value of general purpose equipment could be treated under ASPR 15-205.42(d), since it is included in Section XV, Part 2 of ASPR, i.e., "this Part."

Aerojet General Corporation¹⁴³ discusses some of the basic facts regarding the consequence of a distinction between general purpose and special tooling. Some of the considerations which should be addressed in treating tooling costs, even at the very start of the contract negotiations process, are stated in this case even though it did not deal with a termination situation. The board stated:

[A]ll of the tooling in question was what was described in our record as "gray area" tooling. By that term is meant tooling which is not obviously either special or general purpose tooling. Aerojet has asserted and we believe that normally in negotiation of a cost type contract the contractor seeks to have this gray area tooling declared special tooling so that its costs may be recovered immediately out of that contract. On the other hand, Government negotiators customarily seek to have it declared general purpose tooling in order to spread out the costs over a greater period and reduce the price of the contract then being negotiated.

Actually the Government has much to gain by designating gray area tooling as general purpose. Such a designation makes it a capital asset of the corporation, and it is then subject to depreciation as are other capital assets. Depreciation is an overhead item which is spread over all of the business of the particular cost center including fixed price contracts and whatever contracts there may be which are not with the Federal Government. Thus it is clearly to the contractor's benefit to have the tooling

declared special, for otherwise it stands to lose at least a portion of the cost of the tooling itself in addition to losing the time-cost of whatever money may be tied up in the tooling over its depreciable life. Philosophically, it seems safe to say that costs of tooling are proper charges against cost type contracts, and all tooling which is not special tooling is general purpose tooling.¹⁴⁴

Since the Government in Aerojet General Corporation had elected to treat the tooling as general purpose, it could not later change its position and treat it as special tooling.¹⁴⁵ However, even though the Government is bound, the contractor seems to have some advantage in that Southland Manufacturing Corporation opens up the possibility that general purpose tooling can be treated under ASPR 15-205.42(d) as special purpose tooling and thus have its loss of useful value allowed upon a termination. And, if this is done, the contractor might next argue that he should recover depreciation for it as general purpose tooling up until the point of termination, at which time he will argue for recovery of its loss of useful value.

4. Title to Special Tooling

One possible problem in termination settlements arising out of ASPR 15-205.42(d)(ii) is where the Government wishes to protect its interest by taking possession or title to special tooling, special machinery and equipment, when it has no right to do so. This situation occurred in Allied Materials and Equipment Company¹⁴⁶ where the Government required the delivery of expendable tools and special tools

following the termination. The contractor had purchased this tooling and had used it to perform work in the pre-termination period. Thus it was chargeable to the cost of manufacturing as a direct cost, and the tooling belonged to the contractor.

Part of the contractor's claim was for special tooling and part was for expendable tooling. Expendable tooling is something the Government has a right to acquire under the termination article of the contract, e.g., ASPR 7-103.21 (b)(vi) (A), "other material produced as part of, or acquired in connection with the performance of, the work terminated by the Notice of Termination" The definition of "material" is stated in ASPR 8-101.9 and indicates it applies to "small tools and supplies which may be consumed in normal use in the performance of a contract."

Thus, the board reasoned that the expendable tools were required by the contract terms to be submitted to the Government and the claimant was not allowed his claim for these tools. However, the "special tooling" was found to require different treatment since it is a term which does not include any consumable property, ASPR 13-101.5. The board recognized that special tooling could arguably be considered as part of "material" as defined by ASPR 8-101.9, but since it is clearly treated under ASPR 13-101.5 as something distinct, special tooling is not required to be given to the Government under the termination clause, and

title remains with the contractor.¹⁴⁷ The board used a "jury verdict" basis to decide the amount due the contractor for the Government's wrongful taking of the special tooling. It found that about 10 percent of the original basis of the tooling was expended, and therefore gave the contractor 90 percent of his claim for special tooling. In so deciding, ASPR 13-305.1(a)'s policy that "contractors provide and retain title to special tooling required for the performance of defense contracts to the maximum extent consistent with sound procurement objectives," was affirmed.

Thus, there is a difference in the treatment of tools. The contractor's goal should normally be to consider fitting as many of his tool items as he can under the category of "special tooling," since these tools do not have to be given to the Government upon termination and their loss of useful value can be compensated. It would probably not be advisable to attempt to treat his tooling both as general purpose and as special tooling since the Government has been estopped, as in Aerojet, from changing its position when it was more advantageous to do so, and therefore it would be unfair for the contractor to also attempt this.

F. Rental Costs Under Unexpired Leases

ASPR 15-205.42(e):

(e) Rental cost under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated contract, less the residual value of such leases, if--

- (1) the amount of such rental claimed does not exceed the reasonable use value of the

- property leased for the period of the contract and such further period as may be reasonable; and
- (ii) the contractor makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease.

There also may be included the cost of alterations of such leased property, provided, such alterations were necessary for the performance of the contract, and of reasonable restoration required by the provisions of the lease.

Another important Cost Principle which is not mentioned in the Convenience Termination clause is the fact that after a termination for convenience the contractor is entitled to recover the rental cost incurred under unexpired leases. However, the contractor must be able to "clearly" show that this cost was "reasonably necessary for the performance of the terminated contract."¹⁴⁸ The use of the word "clearly" is remarkable because it is not used as a qualifier anywhere else in the ASPR 15-205.42 Termination Cost Principles, and this is apparently demonstrative of a mandatory requirement that the leases have a very close relationship to the performance of the terminated work. Another requirement is that the contractor must delete any residual value of the lease from his claim; thus, the contractor will have another area worth concentrating his evidentiary efforts upon, i.e., showing that there is either little or no substantial residual value in the unexpired lease.

1. Allowability Beyond Contract Completion Date

A limit on the amount that may be recovered is the

"reasonable use value of the property leased for the period of the contract and such further period as may be reasonable" [emphasis supplied].¹⁴⁹ This is also the only Termination Cost Principle to clearly state that costs are allowable even though they were incurred after the end of the contract; these costs may be allowed for an indefinite time as long as this additional period is "reasonable," and the contractor makes reasonable efforts to settle, terminate, or reduce his lease costs.

One case¹⁵⁰ which exemplifies the scope of allowability of rental costs involves a situation where both a contractor and subcontractor leased property in order to perform a contract for the production of incendiary bomblets for use in Southeast Asia. The contractor was found by the board to have reasonably leased property for production since he had no available and suitable location in-being for the manufacture of this type of product.¹⁵¹ The amount of land leased was more than necessary for the contract work but was leased anyway since the Air Force requested the ability to expand. There was no provision for termination of the lease, but the board found the contractor reasonably felt the lease could be cancelled every four years.

The lease term was for a period of twenty years, even though the contract was scheduled to be fully performed within one year. After the contract was terminated for convenience, the lessor would not cancel the lease. However,

the board found the contractor made reasonable efforts to dispose of the property since he had employed a professional real estate manager to dispose of the property and had tried to use the property in its own business.¹⁵² These efforts were not successful until the contractor finally leased the property to another firm approximately fifty months after the termination for convenience, and more than four years after the contract was to have been completed.

Yet, in the circumstances of the case, the board found that this period of time, even though it extended far past the contract performance time, was reasonable. The board makes it clear there is no automatic point at which rental costs are disallowed. The standard it purports to use is stated as follows:

[i]n determining what a reasonable time is, we must basically look to the efforts made to reduce the lease costs or, stated differently, to dispose of the property by sublease, cancellation, sale, etc. If those efforts are reasonable, in the large majority of cases the time will be considered reasonable as well. The determination of what is a reasonable time is a question of fact.¹⁵³

This standard was used in determining that the subcontractor's efforts to settle its lease were also reasonable. The subcontractor had signed a 99-year lease, since it had only two options, a 99-year lease or an outright purchase of the land. Since less of a cash outlay was required, the land was leased. Efforts to reduce the lease costs included advertising the buildings and equipment for sale

(including advertisements in the Wall Street Journal) and employing a Los Angeles law firm to undertake selling operations. The building was finally sold to a nonprofit institution approximately 27 months after termination, approximately 26 months after performance was to have been completed.

This case cites Pamco Corporation¹⁵⁴ and Southland Manufacturing Corporation¹⁵⁵ as representative of two previous examples where rent was allowed for periods beyond the contract completion date.¹⁵⁶ As was seen in the discussion of ASPR 15-205.42(d) above, the Pamco Corporation case is really more of an example of the application of the Loss of Useful Value Cost Principle since it involves machinery and equipment leases and not real property. However, it does involve the allowability of "rent" on the machinery and equipment beyond the completion date of the contract.

The Southland Manufacturing Corporation case involves a termination for default, which was later converted to a termination for convenience, whereby the contractor was allowed to complete work in process over a period of approximately four months past the date of the termination for default. The contractor in that case had rented property by way of a ten-year lease and was performing the contract on this rented property. After the termination the contractor attempted to sublet the rented property and continued to pay rent on the property in the meantime.

During this time the contractor did succeed in subletting the property for nine months. The Government argued that ASPR 15-205.42(e) did not apply to any period past the time the contractor was allowed to complete work in process. But the board found that the entire period it took to sublease the premises was reasonable, and even granted the contractor the incentive rental allowances which could not be deducted from rent after the contract was terminated.¹⁵⁷

Although American Electric indicates Southland Manufacturing Corporation stands for the proposition that rental costs incurred beyond the contract completion date are allowable, it is not clear from the case history what the contract completion date would have been had there been no termination for default. In other words the facts of the case did not really bear out this proposition.

The Court of Claims, however, has clearly decided the issue of whether rental costs are allowable if they continue past the date on which the contract would have been completed if there had been no termination. In Sundstrand Turbo v. United States,¹⁵⁸ the court was asked to overrule a board decision¹⁵⁹ which had decided that rental costs past this date are not allowable. The board, however, had allowed rental costs incurred between the date of the termination for convenience and the end of the expected contract period, a duration of about ten months, but it had refused to allow rental costs between the expected completion date and the

date the building was subleased to another party, a period of about 29 months. The claim for rent during this 29-month period totaled over \$150,000.

The Court of Claims based its decision on the terms of the contract, which allowed continuing costs for a reasonable time after termination. The court felt that the board had really made a factual determination that this period of time, up to the expected completion date, was a reasonable time under the circumstances of the case. The court concluded that since the decision as to what is a reasonable time is a question of fact, it would not upset the board's determination on this matter; but the court does say explicitly that "we do not agree with the statement of the Board that according to the termination provisions of the contract and ASPR 15, Part 2, 'the maximum reimbursement thereunder is the total that could have become payable to the completion date of the contract.'"160

This latter statement involves a question of law, and the court concluded that as to this matter, the board's decision was erroneous as a matter of law since there can be cases where the Government would be liable for costs which continue for a reasonable time past the completion date of the contract. Thus, although the court actually did decide that in this case the contractor could not collect for costs beyond the contract completion date, it only did so since the board had concluded on the factual evidence that this represented the reasonable time for which these costs should

be allowed.

There is yet another question regarding the timing of allowability, and this deals with the matter of whether allowability depends in any way on when the lease of property is effected. In a Department of Commerce Board of Contract Appeals case¹⁶¹ a contractor was denied any office or equipment rental expenses for the four months after the contract was terminated for convenience. The board noted that these leases were signed approximately three months before the contract was awarded; the office lease was found not to have been executed just for this contract and the equipment lease did not have contracting officer approval. The board does not cite any cases on the rental cost issue, but it is clear it doesn't look favorably on rental claims for unexpired leases if the lease was executed previous to the time the award was made.

This particular circumstance is not controlling, as was discussed above in Baifield Industries, where a lease of property was entered into approximately twenty months before the contract was awarded; the board used the continuing cost principle there rather than the rental cost principle in stating, " . . . that fact does not control appellant's claim. The cost principles do not condition allowability upon the acquisition of facilities, etc., solely for performance of the terminated contract."¹⁶² Although there is no reason indicated why there should not be the same liberality of

allowability of costs involving leases entered into before award under ASPR 15-205.42(e) as there is under ASPR 15-205.42(b), the contractor would be better advised to phrase pre-contract lease costs as continuing costs.

2. Similarity to Continuing and Initial Costs

As was pointed out above, costs under ASPR 15-205.42(b), continuing costs, are sometimes virtually indistinguishable from costs under ASPR 15-205.42(e), rental costs under unexpired leases, but the Rental Cost Principle is sometimes more difficult to use. A further point which indicates the advisability of using the Continuing Cost Principle, if possible, is that this principle does not require that a lease be acquired specifically for the contract. It only requires that there be a "clear connection between the costs claimed and the terminated contract and, further that those costs could not have been reasonably shut off upon the termination."¹⁶³ It would appear that the board will, on the other hand, take a more restrictive view of rental costs and require that they be acquired specifically for the contract. Another drawback to using the ASPR 15-205.42(e) Rental Cost Principle is that the residual value of the lease must be deducted. In some cases this fact alone may be enough to make it worthwhile for the contractor to proceed under the Continuing Cost rather than Rental Cost Principle.

A situation that appeared in the Baifield Industries

case was the specific use of the Initial Cost Principle, ASPR 150205.42(c), rather than the rental cost provision. The board allowed certain start-up costs at the leased facilities of the contractor after award and preparatory to performance. The board indicated that "it is undisputed that the above leasehold improvements were reasonably necessary for performance of the . . . [contract]."164 This finding would seem to indicate that these costs could have been allowable under the provisions of ASPR 15-205.42(e), rental costs, which state that "there also may be included the cost of alterations where necessary for the performance of the contract"

One possible reason why these leasehold improvements were analyzed as start-up costs could be based on the fact that the contractor couched his claim for these cost items on paragraph (e) of the Termination for Convenience clause, which addresses the allowability of initial costs and preparatory expenses allocable to the terminated work and doesn't specifically mention rental costs.

Although the contractor in this case recovered his claim without resort to the Rental Cost Principle, it is not clear he was aware of his full termination rights. These are not disclosed until the contractor goes beyond the Termination for Convenience clause and examines the cost principles. The Rental Cost Principle allows more than just improvements; it also provides for the recovery of

the "reasonable restoration required by the provisions of the lease." It is possible in this case that the lease required restoration and that the contractor did expend some money in restoring the property and preparing it for subleasing. Thus, it is conceivable that the contractor missed an opportunity to recover even more of the costs incurred than he did after the Government terminated for convenience. The fault for not making the contractor whole in such a case would rest primarily on the contractor.

3. Reasonableness Test

The reasonableness test of both the Rental and Initial Cost Principles sometimes doesn't involve simply a question of whether or not the contractor was reasonable in his efforts to terminate or reduce the cost of his lease. As was true in both American Electric and Baifield Industries, the leased property could not be reasonably subleased or disposed of until the termination inventories had been cleared.

It was more reasonable in both of these particular cases to clear the inventory from the leased quarters rather than lease other space for storage of the inventories while disposition was proceeding. Both cases found that the inventory disposal proceedings were reasonable, and this was a crucial first step towards deciding if the disposal of the leased property was reasonable. Since many terminations involve inventory, it may often occur that an analysis of

the reasonableness of the disposition of the leased property will be contingent on the contractor's actions in regards to his inventory. This is a relationship between the two operations which should be noted by a contractor in handling his termination settlement operations and making his claim.

The contractor should not place too much reliance on the ASPR 15-205.12(b) cost principle which deals with "idle facilities." The contractor who is incurring the costs of facilities which have been idled for a variety of reasons, including termination, can normally expect to recover his costs for "a reasonable period of time, ordinarily not to exceed one year, depending upon the initiative taken to use, lease, or dispose of such facilities (but see 15-205.42(b) and (e))."¹⁶⁵ The specific reference to the Termination Cost Principles would seem to indicate that as far as a termination for convenience is concerned, ASPR 15-205.42 will prevail. The contractor therefore should be certain he can meet the more severe standards of the Termination Cost Principles, which will deny continuing costs if he negligently or wilfully fails to discontinue costs, and denies rental costs if he cannot "clearly" show that a rental cost is reasonably necessary in performance.

For this reason, the contractor should not expect reasonableness alone to give a free ride of one year in which to dispose of idle facilities after a termination for convenience. And he should be prepared to show that

the rental costs under unexpired leases were the subject of reasonable efforts to terminate, assign, settle, or otherwise reduce these costs. As long as reasonable efforts exist, these costs can continue past the date the contract would have been completed if it had not been terminated, and still be allowable.

4. Other Rental Claims

In Southland Manufacturing Corporation,¹⁶⁶ the provisions of ASPR 15-205.42(e), dealing with leasehold improvements, i.e., "[t]here also may be included the cost of alterations of such leased property, provided, such alterations were necessary for the performance of the contract . . . , " were at issue. The contractor had claimed the depreciated value of leasehold improvements such as landscaping (required by the lease), construction of partitions, and electrical work. The Government successfully argued these costs were not allowable under ASPR 15-205.42(e) since the landscaping was required by the lease, and the other two costs were required in all of the contractor's work and not just the terminated contract.

But the board allowed these costs under ASPR 15-201 since it felt that no other ASPR provision either allowed or disallowed such costs, and that since the costs were reasonable, allocable, and within the generally accepted accounting principles, the depreciated value of the claim

was allowed. Thus, ASPR 15-201 can be considered for assistance in recovering costs which are not specifically allowable under any of the other cost principles, nor prohibited by any cost principle of Section XV, Part II of ASPR. This is the only example discovered where ASPR 15-201 was used in this manner and does demonstrate that the board will sometimes go out of its way at unpredictable times in order to make a contractor whole.

The board also dismissed a Government argument that the contractor should realize there is a risk that he will not recover his costs, and that therefore the termination settlement should not be the means of bailing him out. The board stated, "we fail to see the relevancy of bidding procedures or even cost negotiations to termination settlements other than a similarity in the applicable ASPR provisions."¹⁶⁷ The implication is that the board does feel the use of cost principles is somewhat different in a termination settlement situation since they are therein utilized to fulfill the special purpose of allowing the contractor to recover his costs.

The absence of a formal lease can sometimes be a hindrance to a claimant who seeks to utilize the ASPR 15-205.42(e) cost principle. In one case,¹⁶⁸ the contractor attempted to recover his monthly rental charges for a nine-month period after a termination for default (which was later converted to a termination for convenience)

until the premises were sold. However, the actual lease of the building had expired during the month the contract was terminated for default, and the contractor had simply stayed on in the building in a month to month tenancy. The primary purpose for remaining was to be poised in continued readiness should the contract be reinstated, since he felt reinstatement was a distinct possibility if he kept the plant facilities ready for production.

The board decided that the claim for rental costs had to be denied since it was not really a claim for an unexpired lease since the lease had already expired. However, the contractor was allowed some recovery for storage of the contract work.¹⁶⁹ This decision does not further the purpose of making the contractor whole, particularly since the termination for default was converted to a termination for convenience. These costs can be traced directly to the erroneous default termination which caused them to be incurred.

In the above case, the board was not able to precisely determine the part of the claim dealing with the post-termination expense involved in dismantling and restoring the facilities; however, the Court of Claims upheld the board's use of a "jury verdict" determination of reimbursement.¹⁷⁰ The court found that this was a justifiable way of allocating costs without imposing additional delay on the administrative proceeding, and it concluded that this resulted in no arbitrary

or unreasonable allocation.

The board¹⁷¹ did not have an easy time allocating costs since the claim included so many items which were discovered to be unrelated to the termination. Also, it found that restoration work could have been completed in a month or two, but the contractor kept his labor on the job for 16 months after the termination. The evidence presented was clearly inadequate to support the claim in its entirety; the board's denial of \$48,000 out of the \$86,000 claimed represents a clear warning, since it was upheld by the court, that a contractor runs a serious risk of having to fund his own post-termination inefficiency and ineconomy unless he can show the expenditure was reasonable and supported by clear and accurate evidence.

One way to avoid problems like this is to set up a separate termination account, particularly for labor and particularly if there are other contracts underway. Then there will likely be fewer questions raised as to how much labor was involved in the termination. Estimating these costs later may necessitate the use by the board of the Court of Claims' sanctioned brand of calculation, the "jury verdict," which may not always be favorable to the contractor.

In a case¹⁷² of insolvency upon termination, the board encountered a situation where the contractor's lease continued past the termination point of the contract. The Government wanted to deny the unexpired lease claim since the leased

property was used in all of the contractor's business. However, since the contractor went insolvent at the time of termination, there was no other continuing business. The board's solution was essentially another jury verdict based on the proportionate share of the rent equal to the ratio that the amount of general and administrative (G & A) expense allowed related to the total fiscal year G & A pool.¹⁷³

In sum, the Rental Cost Principle represents a partial constriction on the more broadly stated Continuing Cost Principle, which overlaps it in coverage. The Rental Cost Principle requires that the contractor "clearly" show the lease's relation to the terminated contract, and he must also deduct any residual value of the lease, as well as make reasonable efforts to diminish its cost. The only advantage from the use of this cost principle may derive from the fact that alteration and restoration costs are specifically allowable, assuming the alterations were "necessary" and the restoration "required" by the lease.

G. Settlement Expenses

ASPR 15-205.42(f):

(f) Settlement expenses including the following are generally allowable:

- (1) accounting, legal, clerical, and similar costs reasonably necessary for--
 - (i) the preparation and presentation to contracting officers of settlement claims and supporting data with respect to the terminated portion of the contract, and

- (ii) the termination and settlement of subcontracts;
- (2) reasonable costs for the storage, transportation, protection, and disposition of property acquired or produced for the contract; and
- (3) indirect costs related to salary and wages incurred as settlement expenses in (1) and (2); normally, such indirect costs shall be limited to payroll taxes, fringe benefits, occupancy cost, and immediate supervision.

One of the most frequently mentioned provisions in the decisional law concerning convenience termination settlements is the cost principle dealing with settlement expenses. One reason for this may be that attorneys fees are included in this cost principle, and since attorneys often are instrumental in the filing of claims it is perhaps only natural that their fee, since it is an allowable cost, will appear in virtually every claim. This discussion will focus on four areas of settlement expenses: 1) attorneys fees; 2) accountants fees; 3) clerical and other reasonably necessary expenses; and 4) storage, protection, and allowable indirect costs.

1. Attorneys fees

The Government may contribute to the complexity of a settlement and thus increase the size of attorneys fees. An example of such a situation occurred when the board awarded the contractor over \$30,000 worth of attorney fees (the contracting officer had only allowed \$5,000) because of the Government's "indecision and vacillation" which drew the settlement proceedings out an abnormally long time.¹⁷⁴

In this case, the same law firm used by the contractor was also used by the subcontractor in presenting its termination claim, (vom Baur, Coburn, Simmons & Turtle). The board did not question the magnitude of the counsel fees since the record adequately portrayed the complexity of the case and the need for "these individuals (who) are clearly experts in their respective fields with impressive backgrounds. The file clearly and uncontrovertably reflects their efforts, which were substantial."¹⁷⁵

The Government argued it should not have to pay attorneys fees for the subcontractor since there were no actual negotiations between the contractor and subcontractor. The board found this argument to be without merit since allowability is not predicated upon negotiations taking place.¹⁷⁶

Another Government argument was that before a claim can be allowed, it must relate to a valid or approved claim. This was rejected since a claim does not have to be approved before the costs of preparation and presentation of the claim are allowable. The board cited an earlier decision on the point that as long as the claim is not "so patently invalid" that its preparation cost is unreasonable, the contractor is entitled to be paid the reasonable expenses of preparation and presentation of that claim.¹⁷⁷ Thus, the test is that first the claim must not be patently invalid, then the costs of the claim preparation must be reasonable in amount.

One sizable board decision¹⁷⁸ involving the attorneys fee issue during the past year concerned a claim for legal charges of over \$82,000. The TCO allowed only \$9,600 and dismissed the rest as unreasonable. The total termination claim was approximately \$1-2/3 million, of which the contractor ultimately recovered, including attorneys fees, about \$1-1/6 million. The board's decision is detailed, instructive, and is the most recent discussion concerning many of the salient issues regarding the allowability of attorneys fees in a termination for convenience settlement. For this reason the first part of the discussion on attorneys fees will focus on the guidance this case sets forth.

First, there was an issue as to whether or not attorneys fees could be disallowed to the extent that they involved efforts to convince the contracting officer that the termination for default was improper. The board did not agree that there is a distinction in treatment in the Termination for Convenience clause and the cost principles between costs incurred to establish the error in a default termination and the efforts to establish the quantum that could be recovered in a termination for convenience settlement. Thus, the board would allow the reasonable efforts to overturn the default termination at the contracting officer level. There is no requirement that the Government recognize a termination for convenience at the time the contractor incurred the expenses; if the termination for default is

later converted to a termination for convenience, the contractor should recover these costs. Thus, such costs were allowable here since a previous board decision¹⁷⁹ had held the termination for default improper and had converted it to a termination for convenience.

A second point involved a Government argument that some of what was billed as attorneys' time really included work which could have been carried out by the contractor's management. Although this was recognized as a factual possibility, the important point made by the board was that it put the burden of proof on the Government to demonstrate what part of the billing was not legal advice or assistance reasonably requested by the contractor. Thus, the test tends to be not so much what was done, but what was requested. The board also makes it clear it will not examine every quarter hour of billing to determine if it might not have been for work which doesn't require an attorney's expertise.¹⁸⁰

A third point involves the Government-caused multiplication of the legal effort expended because of its allegations, during the settlement negotiations, that a loss adjustment would be necessary. This resulted in a substantial amount of attorney time in interviewing employees and preparing a defense to a loss adjustment. The board also pointed out that the inexperience of the contractor in Government contract terminations made his excessive reliance on his attorney reasonable, and it indicated it would not tolerate

a narrow scope of legal services, particularly where the efforts to gather facts may be so determinative of the ultimate recovery.

As a fourth matter, the Government argued that attorneys fees included a great deal of clerical and administrative work. It attempted to rely on American Packers,¹⁸¹ where some attorney charges were not allowed for research on issues governed almost exclusively by forms and regulations when no need was established to research these matters. However, in the case at hand, the attorneys made contemporaneous "day notes" which showed that their work was related to the termination settlement. The test put forward is that " . . . none of the work performed by the vom Baur attorneys, for which claim is made, was so patently ministerial that it should not reasonably have been performed by them."¹⁸²

A fifth item concerns attorneys' travel expenses. This issue was raised in a motion for reconsideration,¹⁸³ and it was decided there that travel time for attorneys is properly includable in the claim, despite the Government's argument that such an expense does not relate directly to the preparation and presentation of the settlement claim.

The original decision discussed the fact that the termination was accomplished in the Dallas, Texas area but that the contractor's attorneys were from Washington, D.C. The board found that there was no evidence that any attorneys competent to provide this "sophisticated, time consuming legal service" were available in Dallas and stated

it did not want to deny contractors "the services of attorneys, few in number, who have considerable experience in handling complex termination claims under Government contracts."¹⁸⁴

The Government disagreed with this decision and asked for reconsideration. Upon reconsideration, the board did take official notice that Dallas has a number of attorneys who practice in the public contracts field. However, these expenses were still allowed since the Government did not show "that had appellant approached such competent Dallas attorneys it would have been able to obtain the extensive and highly sophisticated legal services required at the time appellant needed them."¹⁸⁵ It then went on to find that travel expenses were a minimal part of the claim and were necessary in order to utilize these attorneys.

A sixth point is that the contractor can claim the legal expenses directly necessitated by the TCO. In this case, the TCO requested by letter certain "precise details" on the termination involvement of the attorneys and accountants. The contractor was thus able to claim approximately \$2,500 for the attorneys' time expended in preparation of a detailed legal expense exhibit showing how the legal and accounting effort had been incurred.¹⁸⁶

The result was that the board allowed the \$82,649 claim for legal expenses in its entirety, approximately \$73,000 more than the TCO had allowed. The case shows

that a contractor can hire the best attorneys in the Government contracts field, and as long as their effort is documented and reasonably related to the needs and requests of the client, the board is not likely to deny these costs even though they may seem high or the work contains some amount of nonlegal character in it.

The contractor is not always this successful or adept at recovering attorneys fees. In H & J Construction Company,¹⁸⁷ the contractor's problems began with the fact that his claim for attorneys fees was not separately itemized in his settlement expense claim. It was instead included in the general expenses of the claim. Adding to this difficulty, the contractor was represented at various times by four different attorneys. He could only come up with a total of one billing, from just one of the attorneys, and even this billing was for time spent after the final decision of the contracting officer and during the time he was appealing to the board. The end result was that the recovery on a claim for \$48,500 for attorneys fees was an award of \$500, based on a "jury verdict" determination.¹⁸⁸ The board suggested that the claimant was probably confused to some extent between settlement preparations and negotiations on the one hand, and appeal preparations on the other. Thus, contributing to the problem was the fact that the claim consisted of the legal costs of prosecuting a claim against the United States, a cost which is unallowable under

I

ASPR 15-205.31(d).

This same kind of problem appeared in Dairy Sales Corporation,¹⁸⁹ where the record was also not clear that the claim for attorneys fees was for services associated with the preparation and negotiation of the termination settlement claim rather than the cost of appealing the claim to the board. Another problem was that some of the legal effort was apparently spent on preparing a claim for anticipatory profits, a cost which is also not allowable.¹⁹⁰ And finally, the overall "lack of complexity" of the claim indicated to the board that the claim for \$2,500 for attorneys fees was more reasonably payable only in the amount of \$500, based on a "jury verdict" determination. The board did not disagree with the rate that attorneys fees were billed, i.e., \$50 per hour, but simply disagreed with the reasonableness of the number of hours which were asserted. The board did not discuss here any variable other than the complexity of the work; it didn't mention whether counsel was skilled or familiar with Government contract work. Perhaps the contractor could have made a case that his counsel was not skilled in these matters and therefore should be allowed some consideration for attaining a degree of familiarity with the case and the intricacies of applicable procurement law.

The hourly rate of attorneys' work does not seem to be questioned to any extent at all by the board. In

Switlik Parachute Company,¹⁹¹ the attorney charged \$100 per hour for 48 hours of work in preparation of a termination settlement proposal. Since the Government did not challenge the hourly rate, other than a view expressed by the Government auditor that "\$100 is a lot of money to pay an attorney,"¹⁹² the board did not question this pay rate either. It did indicate that no issue was raised as to the attorney's ability and experience.

The Government belatedly put forth an argument in its post hearing brief to the effect that legal fees for attorneys' travel time should not be allowed.¹⁹³ The board seemed to base its approval of allowability on the fact that the Government did not provide any evidence that the billing was not common practice in the profession, and it also indicated the issue was raised too late for the contractor to present any evidence.¹⁹⁴ Thus, it allowed the billing for travel time, which was charged at the full \$100 per hour rate. The board therefore seems to be prepared to allow a full hourly charge for travel time if the claimant can make some showing that this is the normal practice in the profession, and perhaps even upon a showing that this is this attorney's customary billing practice. It also appears that the board will then put the burden of proof on the Government to show that this isn't the professional practice.

The costs incurred in defending suits brought by subcontractors is an allowable attorney cost, as is pointed

out by R-D Mounts,¹⁹⁵ however, in that case the contractor attempted to collect the costs incurred regarding fifty-one actual or threatened lawsuits against the contractor, many of which were not brought by subcontractors under the contract. The board agreed that the non-subcontractor suits were too remote to be recoverable as part of the termination settlement. The Government attempted to go even further, however, and have the subcontractor-suit attorneys fees rejected because the attorneys intended to base their fees on the financial condition of the contractor. The board said this is not the kind of "contingent" fee barred by ASPR 15-205.31 since these fees were not based on a recovery from the Government.¹⁹⁶

The R-D Mounts case also demonstrates that the allowability of attorneys fees is not based on the seriousness or magnitude of the matter for which legal advice is rendered. In this case, part of the claim was for slightly less than \$1,200 for defense of a subcontractor suit which had been brought for \$1,200 in order to recover the cost of unpaid materials occasioned when the Government withheld progress payments and then terminated for default. The board held that these attorneys fees are allowable, citing Nolan Brothers Inc. v. United States¹⁹⁷ (where the court had upheld an award by the board of the attorneys fees, court costs, and judgment incurred by a prime contractor in litigation with a subcontractor). The board

further stated that the contractor "should not be deprived of legal counsel because the amount of its potential liability is small. In our judgment no one can be accused of being imprudent for retaining an attorney when confronted with a possible lawsuit."¹⁹⁸

Sometimes, in order to recover counsel fees, it is helpful to be known for one's expertise in Government contracts. In the Liodas¹⁹⁹ case, the board pointed out the contractor had "employed Jack Paul, well known to industry and the bar as a specialist in Government contracts, and his associate Gerald Gordon. Mr. Paul was known by the TCO and his counsel and his integrity was unquestioned." After this plaudit, there was little difficulty in the contractor recovering the retainer of \$3,500, but minus \$80 for an amount which represented effort expended on the appeal to the board.²⁰⁰

And in Cyro-Sonics,²⁰¹ an hourly charge of \$100 for legal services for the contractor's attorney, Mr. Gubin, was buttressed by the board's recognition of his "extensive experience and knowledge on matters relating to Government contracts."²⁰² The Government attempted to attack the hourly fee as too high, based on the fact that a prominent Los Angeles attorney (the contractor's plants were located in the Los Angeles area) charged only \$65 per hour. The board ruled that " . . . the 'locality' for legal services performed in connection with the termination settlement of

a United States Government contract would reasonably include Washington, D.C., Mr. Gubin's place of business, as well as Los Angeles."²⁰³ Thus, the board essentially opens up the entire United States as the "locality" to be considered when determining the reasonableness of attorneys fees, and this means that there is an opportunity for Government contract attorneys to base their hourly pay scale for convenience termination work on what is charged in more "expensive" areas such as Washington, D.C.

The board in this case did allow the attorneys fees that were spent in defending the company against a suit by a subcontractor on the basis that this was unavoidable litigation in the process of settling the subcontractor's claim.²⁰⁴

Although the board is not prone to question the hourly rate for legal services, it may very well question the total legal fee charged as compared to the size of the claim. In American Packers,²⁰⁵ the contractor's claim for over \$4,700 in attorneys fees for a \$20,000 claim did not succeed because the board felt this represented an unreasonable number of hours in relation to the "size" of the termination claim. One factor that helped the board arrive at this conclusion was the fact that the contractor's manager apparently shifted some of his work to the attorney, which was then billed at the professional rate. Another point was that a number of hours were spent on researching matters which were really

controlled for the most part by forms and regulations, and this cast doubt on the number of hours spent on the claim.²⁰⁶

Attorneys fees have sometimes been allowed on a daily fee basis, e.g., Douglas Corporation,²⁰⁷ where Mr. Gubin was allowed his services at the rate of \$250 per day, which is what he and the parties agreed to as a fee schedule.

The fact that attorneys fees are not allowable for such things as prosecuting a claim before the Board of Contract Appeals or Court of Claims should not stop the contractor from claiming attorneys fees for legitimate settlement negotiations with the contracting officer even if these negotiations are going on during the same time as the board or court action. The authority for a claim at this point is found in Acme Process Equipment Company v. United States.²⁰⁸ The only real burden on the contractor is to be able to show that these charges relate to the claim presented or negotiated with the contracting officer. The best way is to show there were actual settlement negotiations with the contracting officer. The dividing line the Court of Claims has laid down is between negotiation and litigation, and not the point in time when the appeal was filed.²⁰⁹ In other words the contractor should be able to show that the attorney fees related to the claim presented to the contracting officer and not the appeal to the board.²¹⁰

But if the attorneys fees actually related to "prosecuting" a claim against the United States, they are not

allowable. The rule has been long established that attorneys fees are not allowable against the United States unless there is a statute or contract which allows them.²¹¹ The Termination for Convenience clause of the contract, paragraph (e)(iii), presents such an exception to this general rule as far as preparing and presenting a claim to the contracting officer is concerned. This clause in paragraph (f) states that the ASPR Section XV Cost Principles apply, which means that ASPR 15-205.42(f) is also authority for the allowance of attorneys fees for settlement with the contracting officer. But there is no such specific contract authority for allowing attorneys fees for pursuing an action before the board or the Court of Claims.

2. Accountants Fees

Accountants fees are much like attorneys fees in that the contractor can hire and be reimbursed for their expert assistance. In American Electric,²¹² the contractor procured accounting assistance from the Arthur Andersen & Company's Pittsburgh office. Because the claim was so complex, an Arthur Andersen expert in their Chicago office was even brought in. The contractor recovered the accounting charges claimed particularly since the course of the settlement negotiations necessitated that the contractor first prepare his claim on a total cost basis, and later on the inventory basis. The result was that the contractor was allowed the expense entailed in hiring a top accounting firm plus the expense of

using the company's best expert services even if the expert was located in a different city.

In Baifield Industries,²¹³ the contractor also hired the Arthur Andersen & Company firm. The board found this to be reasonable, particularly since the contractor's in-house accounting department had no substantial experience with terminations of Government contracts, and probably did not have the manpower to cope with the complex claim in this case even if it would have had the experience. Also emphasized was the immediate need to settle subcontractor claims. This particular firm was picked among other reasons because it was felt that the accounting firm's independent corporate existence would give its report more credibility. The board did not take issue with any of the reasons given for the selection of this accounting firm and found the choice reasonable.

One important part of the accounting and legal effort in the Baifield case was the effort expended immediately after the termination for default in an effort to support a termination for convenience. For instance, the accounting firm prepared a termination proposal for use in negotiating with the contracting officer and also performed detailed analysis of the contractor's accounting records, verified its inventory, and reviewed all subcontractor claims. And its most important work was the rebuttal to the DCAA audit report which showed the contract would have incurred a

substantial loss. The board decided that all of these costs were directed towards a settlement with the contracting officer; the purpose of the expenditure was the important factor and not its timing as to whether it was before or after the conversion to a termination for convenience.²¹⁴

The Government attempted to attack the fact that part of the accounting work could have been done in-house and that the accounting analysis was excessively detailed. The board seems to reject any notion that a firm hired to perform accounting work involving a termination settlement needs to rely on in-house accounting skills, since professionally " . . . it was reasonable for the Arthur Andersen personnel to verify for themselves the accuracy of recorded costs and to test the Baifield accounting system for reliability."²¹⁵

Also the board points out that the forms used in termination settlements require a certification on each termination proposal, and it is also reasonable to expect that an accounting firm will thoroughly investigate costing data before executing such a certification. The result is that the board has developed a type of built-in allowable cost associated with verification before certification which will occur in virtually any termination settlement proceeding. The only limit the board seems to put on investigation of costs prior to certification is that it not be "unreasonably excessive."²¹⁶

The Government also sought to disallow some of the accounting charge on the basis that the Arthur Andersen & Company's Dallas office should have handled the termination settlement work, and thus some of the travel and per diem expense could have been eliminated. The board allowed these costs because the firm did not have personnel experienced in Government contract terminations in its Dallas office, and thus it was reasonable in bringing in company personnel from other offices such as St. Louis and Chicago.

Thus, the board is not inclined to require that geographical limitations be placed on the employment of professional services such as accountants and attorneys. There is no requirement that this work be completed in-house since, with few exceptions, it would be possible to argue that the in-house staff of a contractor does not have either the experience or the capacity to engage in a termination settlement. There appears to be a built-in recognition that the termination of Government contracts is an area of special expertise, and that the best accounting and legal firms, even if they are in Cleveland or Washington, D.C., and the contractor's operations are in Texas, can be hired and the expenses of travel treated as a necessary component of the furnishing of the professional services.

There have been cases where accounting charges have been cut, but they seem to be relatively rare. Apparently, most accounting firms are conscious of the need to keep

accurate and complete records on the work they accomplished and appreciate the necessity of being able to justify the hours of effort they expend and bill. One exception, mentioned above in the discussion relating to attorneys fees, is the Dairy Sales Corporation²¹⁷ case in which both the attorneys and accounting fees were cut in view of the "lack of complexity" of the claim; a jury verdict basis for calculation of a reasonable amount of professional fees was then substituted. The problem seemed to be that there was a dearth of information as to the work accomplished, and what evidence there was indicated substantial effort was directed towards claiming anticipatory profits, which are unallowable. The result was that accounting charges were cut 75 percent to \$400, from \$1,600.²¹⁸

Another example of a disallowance of some accounting fees is in Engineered Systems,²¹⁹ where the contractor claimed 80 hours of accounting work for the preparation of a settlement claim involving the costs of retraining and reassigning two employees. The Government succeeded in reducing the claim by more than 75 percent on the basis that it was simply unreasonable to expend this much effort in the production of a three-page claim, and the board concurred by stating, "it is difficult to imagine what could have taken an accountant 80 hours."²²⁰

The Government also had argued a separate point for disallowance, stating that in the alternative the cost should

be denied since the claim was so obviously invalid that it was unreasonable to spend time on it. The board stated that "while we would not disagree with the concept that some claims are so patently invalid that the cost of their preparation is totally unreasonable, we do not think the clause contemplates payment of settlement expenses for the cost of preparing only valid claims."²²¹

Thus, if the claim is one that can be reasonably made, the professional fees expended in preparing it are allowable even if the claim is denied. The board will be relatively tolerant of claims made by the contractor; the only exception would be an unreasonable claim which is "patently invalid," as for example one that is for something that is expressly unallowable, such as anticipatory profits.

Also denied are attempts to add a percentage of overhead and G & A to the hourly charge for accounting fees. The board indicated that the Government was correct in questioning the allowability of an overhead and G & A burden when ASPR 15-205.42(f)(3) explicitly states that only indirect costs such as "payroll taxes, fringe benefits, occupancy costs, and immediate supervision" related to salary and wages incurred as settlement expenses will normally be allowable. Here, the contractor made no effort to indicate if any of these allowable indirect charges were included in the claim.

In Cyro-Sonics²²² the board indicated that it will

monitor claims for accounting fees to see that there is no violation of ASPR 15-205.31, which prohibits the allowance of accounting fees for prosecution of a claim against the United States. The standard is the same as for attorneys fees, i.e., as long as the cost was incurred for the purpose of negotiating a claim with the contracting officer, even after his final decision has been rendered and an appeal is taken to the board, and the costs are not incurred solely for prosecuting a claim before the board or court, they are allowable.

One question that may arise is what professional costs to allow if they were incurred or used for both settlement negotiation and an appeal. It would seem that as long as the contractor can show that he did incur the costs for the purpose of negotiating a termination settlement with the contracting officer, he should be able to recover these costs even though the same information and analysis could later be used to prosecute a claim against the Government. This result was recognized in the Baifield case where a memorandum prepared for claims purposes at the contracting officer level was also useful for litigation. The board stated, "[h]owever, that consideration does not disqualify the expense of preparing the memo as a settlement expense."²²³ This language may be particularly significant as it appears to signal the removal of some of the distinction between settlement expenses incurred at the contracting officer level

and at the appeal level. A contractor should be aware of the possibility that he should claim as much of his attorneys fees and other settlement expenses as possible, even if they were really more directed towards a possible appeal, in his termination settlement claim. In other words, the expense of an appeal should be considered early-on and the preparations should be instituted during the claims settlement process so that they might be recoverable as part of the settlement. These expenses can even be claimed after a final decision and an appeal is filed, as long as the expenses demonstrate some connection with negotiations with the contracting officer.

3. Clerical and Other Reasonably Necessary Expenses

Also allowed as a settlement expense is the cost of clerical and other services reasonably necessary in preparing and presenting the termination claim to the Government, or in preparing settlements with subcontractors. These costs are allowable under ASPR 15-205.42(f)(1).

One of the larger claims for this type of cost occurred in American Electric,²²⁴ where the claimant requested approximately \$110,000 for administrative and management expenses for such items as salary, travel, telephone expenses incurred both before and after the final decision of the contracting officer. The contracting officer allowed only \$10,000. The board in this case did not find any problem with the lack of records to support the claim since the

claimant lacked experience in these matters, and it accepted the estimates of cost supplied in accordance with ASPR 8-301(c) which states in part, "[t]he amount of record keeping, reporting and accounting in connection with the settlement of termination claims shall be kept to the minimum" As was pointed out earlier, however, the board is not always as liberal in its use of ASPR 8-301(c) as it was in this particular case. The contractor, here, did recover his administrative and management expenses incurred before the final decision of the contracting officer, but he was denied those expenses occurring after the decision, other than a minor amount for property disposal efforts, since it was found these costs were allocable to the appeal to the board.²²⁵

After a time, the repetitive denial of the expenses incurred in prosecuting a claim to the board would seem to render this a hopeless issue which a contractor should not even consider raising. The circumstances in American Electric typify the contractor's reasons for continuing to assert these claims. After having the \$110,000 claim cut by the contracting officer to only \$10,000, which was obviously an inadequate amount, particularly since even the DCAA auditor agreed with the contractor's claim, the only possibility for relief was to appeal. The board on appeal allowed the entire original claim for pre-decision administrative and management expenses.

This decision, even though it appears to be completely

favorable, does not really make the contractor whole since he was forced to undergo the expense and delay of an appeal to the board, which didn't decide the issue in his favor until 27 September 1976, more than five years after the contracting officer's final decision. The problem is that the Government has very little to lose by making small awards and thereby putting the contractor to the task of appealing to the board. This reflects the fact that "while an equitable settlement is the goal of negotiation, the amount is determined by adversaries, not by judges."²²⁶

This is perhaps more of a serious problem than may appear at first blush. Although the contractor is entitled to simple interest between the date of the final decision of the contracting officer and the date of mailing a supplemental agreement carrying out the board's decision,²²⁷ this probably does not even keep pace with the cost of inflation over the same time.²²⁸

Although the board has not made the contractor whole, even by awarding the contractor his entire claim incurred more than five years earlier, the only solution would be a modification of the Termination for Convenience clause and the cost principles so that the expenses of pursuing an appeal are made allowable. But, in the meantime, the contractor would be well advised to carefully consider the probability that even a successful appeal to the board may be time consuming and not without some costs, and therefore

he should make even more of an effort to present a convincing claim to the contracting officer. For one thing, he may be able to work out a successful settlement at that level; and for another, these costs could be recoverable even though they are also useful for preparing the type of case which would be necessary to present before the board on appeal.

In Baifield, the termination settlement expenses claim included billings for telephone, telegraph, reproduction, car rental, and a proportionate amount of the salaries of certain personnel. The Government questioned the salaries claim since this would normally be an item in the G & A pool. But since the claimant's G & A pool allocable to the contract excluded the entire salaries of these employees during the time in question and placed them under a direct cost heading (Divisional Burden), this was allowable as part of the termination settlement claim. Since the direct in-house settlement expenses grouped under Divisional Burden didn't also cover the expenses included in the G & A pool, there was no duplicate charging and the contractor was thus successful on this claim.

Business judgment also plays a role. The salary and expenses claim included, in part, an allocable portion of the salary and expenses of an employee who periodically commuted between his home in Shreveport, Louisiana and Carrollton, Texas over a period of more than five years while

working on the termination settlement. The board saw no necessity for the employee to have been transferred to Carrollton since at the time of the termination no one could predict the extended duration of the termination proceedings, and the ASPR 15-201.3 definition of reasonableness gives a wide latitude for business judgment.²²⁹

The work involved in actually preparing the termination settlement claim should be fully documented as to the number of hours expended, when the effort was made, by whom, and for what purpose. In Codex Corporation,²³⁰ the contractor was not able to furnish such records as to the number of hours expended. Such a situation would present the risk that at least some of the claim could be denied; however, this case illustrates one way this result can be circumvented since the board accepted affidavits of the individuals involved as to the specifics of what work was accomplished, when it was completed, and how many hours were expended. Thus, as long as the contractor can show that the claim was not "frivolous or so patently unreasonable that the preparation of the settlement proposal was also unreasonable,"²³¹ he should not be deterred from submitting a claim even though he lacks specific documentation.

The Liodas²³² case raised a different issue regarding settlement expenses. The contractor, there, attempted to collect the value of a consultant's services; however, this was denied since the consultant was not really a cost to the

contractor since his compensation was figured on a contingent fee basis. Consulting fees are allowable professional fees as long as they are " . . . not contingent upon recovery of such costs from the Government."²³³ Since the contractor and the consultant had a written agreement clearly setting out the contingent fee nature of compensation, there was really no question this would not be allowable under ASPR 15-205.31 and the Anti-Assignment of Claims Act, 31 U.S.C. § 203, on which this ASPR provision is based.

Another example where settlement expenses may be denied is the case²³⁴ where a committee of the contractor's creditors was formed after the contract was terminated for default. The problem here was that the expenses relating to the creditors committee often didn't relate to the settlement of the terminated contract and, thus, the claim was denied. The result was that an effort to placate creditors, which is often necessitated by a termination and may even be necessary to the continued existence of the business entity, is not allowable as a settlement expense. But the board did allow such expenses as office rent, telephone, xerox, stationery, and automobile rental, as well as the allocable portion of the salaries of the president and the vice president. The TCO had allowed only \$7.00 per hour for their salaries, but the board found this to be insufficient since they were not doing routine work and it

was not unreasonable for them to be working on the settlement since it was so important to the company.²³⁵ However, officer salaries are not always allowable. A contractor is not able to recover the cost of employee compensation when it is used to pursue an action before the board to reverse a default termination.²³⁶

4. Storage, Protection, and Allowable Indirect Costs

The contractor is also allowed, by ASPR 15-205.42(f)(2), to collect the reasonable costs for the storage, transportation, protection, and disposition of property acquired or produced for the contract. Protection costs have included the cost of guard service to protect the work in process in a plant after termination and are allowable even though some of the property being protected is the contractor's.²³⁷

Thus, even though the guards were really guarding both Government and private property, there did not seem to be any requirement to allocate the cost of the service between property acquired for or produced by the contract and other property, such as contractor-owned tools, being used for instance on another contract.

The standard for allowability seems to be that once again the rule of reason applies. The Government will pay what is a reasonable amount of storage charges, and for a reasonable time, until arrangements can be made for disposition of the property.²³⁸ Q.V.S. Inc.²³⁹ allowed the

storage of property for three and one-half years after the termination for default until it was converted to a termination for convenience.

The cost of tearing down a production line is another type of claim which has appeared after a termination for convenience.²⁴⁰ But the board rejected the notion that ASPR 15-205.42(f)(2) applied since its applicability to disposition of property is limited to "property acquired or produced for the contract," and thus this provision would not apply to space or equipment, as opposed to property, used in production. Also ASPR 15-205.42(b), continuing costs, would not seem to apply either since this is not a cost that existed previous to the termination.

The Government argued that these tear-down expenses must be charged as an overhead item and thus cannot be charged directly. The board stated, "[t]here is nothing objectionable about charging any cost directly, provided it is properly allocable to the contract, and other costs of the same character are excluded from indirect pools charged to the contract, in order to avoid 'double screening' or duplicate charging."²⁴¹

The above statement expresses a concern the Government typically has in regards to double screening when the contractor attempts to recover his post-termination G & A. The claimant may very well encounter the board's discontent as well; as it said in one case, the contractor "has cited

no authority or precedent for allowing post termination G & A as such, and we know of none."²⁴² This, however, is not an entirely accurate representation since ASPR 15-205.42(f)(3) explicitly allows some items, such as payroll taxes, fringe benefits, occupancy cost, and immediate supervision charges which are related to the salary and wages incurred as settlement expenses.

And Baifield stated that where the G & A has not otherwise been treated as direct charges, the part that is allocable to continuing contract costs, settlement expenses, and settlements with subcontractors will be allowed. "Such G & A expenses have been routinely allowed by this Board where shown to be incidental to the termination of work under the contract, or properly allocable to subcontractor settlements or the preparation and negotiation of settlement proposals."²⁴³ The point is that, contrary to what one Government contract attorney has written,²⁴⁴ ASPR 15-205.42(f) is opened up to more than just the named indirect costs (payroll taxes, etc.) listed in paragraph (f)(3), since it would appear that all types of G & A can be allowable as long as it has not been otherwise treated as a direct charge. Thus, it can be argued that settlement expenses should be allowed to bear their fair share of G & A just as continuing costs can.

Another accompaniment, besides G & A, to settlement expenses should be a claim for profit. As one author has

indicated, in arguing against those who would deny the contractor any profit on the expenses of settlement under ASPR 15-205.42(f), "[t]he concept is wrong because settlement expenses represent contractor effort expended on the contract just as truly as do direct material and labor.²⁴⁵ He feels that the settlement expenses are directly related and beneficial to the termination and were incurred only because of the Government's act of terminating the contract. Although profit should arguably be allowed in order to make the contractor whole for the effort he has had to expend, because of the Government's exercise of its termination option, this will take an ASPR change since neither the contract nor the cost principles allow profit on settlement expenses.

H. Subcontractor Claims

ASPR 15-205.42(g):

(g) Subcontractor claims, including the allocable portion of claims which are common to the contract and to other work of the contractor are generally allowable. An appropriate share of the contractor's indirect expense may be allocated to the amount of settlements with subcontractors, provided, that the amount allocated is reasonably proportionate to the relative benefits received and is otherwise consistent with 15-201.4 and 15-203(c). The indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

This is an important Termination Cost Principle since in virtually all contracts of any magnitude and complexity there are various subcontracts which must be terminated. The contractor is entitled to recover the sum he pays in

settlement of the claims asserted by his subcontractors, as well as the portion of his indirect expense incurred in making this settlement.

When a subcontractor settles with a prime contractor, he will be able to get the same type of recovery as the prime contractor if he also has the protection of a Termination for Convenience clause. Thus, a subcontractor should be fully aware of the provisions of ASPR 15-205.42 and make his claim accordingly.

One possible confusing situation is the fact that the cost of a subcontractor settlement under ASPR 15-205.42(g) may sometimes be mixed in with a claim for the settlement expenses incurred for the termination and settlement of a subcontract, allowable under ASPR 15-205.42(f)(1)(ii). In Magnavox Company²⁴⁶ the contractor's attempt to claim his termination settlement with a subcontractor was denied by the contracting officer as an allowable termination expense. The board did not mention whether this claim could have been payable under ASPR 15-205.42(g), but the board did allow the claim to be paid out of the unspent funding margin at the time of termination. The case does not seem to reflect on the fact that if the margin had in fact been nonexistent, the contractor would have had no money to recover against. In other words, allowability appeared to hinge on the fact there was money to cover the expense rather than the fact that it was expressly allowable under ASPR 15-205.42(g).

Evidentiary support for recovery of a subcontractor settlement under ASPR 15-205.42(g) is as important to the success of a claim as it is in any of the other Termination Cost Principles. As was discussed regarding the Colonial Metals Company²⁴⁷ case involving the Common Items Cost Principle, where the contractor could not show that he actually settled with his subcontractor, and in fact had continued his account after the termination, the claim will be denied. But assuming there is evidence of payment, a claim for subcontractor cancellation charges, even arising after a partial termination for convenience, can be paid.²⁴⁸

1. G & A

As was discussed above in relation to settlement expenses, G & A can be allowable as part of a claim for subcontractor settlement costs. The Baifield case indicated that as long as these costs in the G & A pool have not been elsewhere charged directly to the contract, they can be allowed.²⁴⁹ However, it is important to note that there is one important qualification; not all G & A will be allowed since it has to be "incidental to termination of work under the contract in the sense of normal applicable indirect expense . . . not incidental to such termination as unabsorbed overhead."²⁵⁰

Another G & A issue is represented in American Electric,²⁵¹ where the contractor claimed that the G & A rate should apply to the subcontractor claims made for

subcontractor work performed before termination. This issue was probably well settled by an earlier board decision²⁵² where the Government had unsuccessfully argued that G & A could not possibly be allocable since the contractor had never even possessed the subcontractor inventory. Thus, this type of claim is allowable whether the contractor took delivery of the subcontractor's end product or not.

In summary, G & A expense is allowable in a subcontractor settlement, but as was pointed out by the Court of Claims in Sundstrand Turbo,²⁵³ the contractor will not be allowed to collect this both as direct settlement expense and also as an allocation of indirect costs of the same type. If the contractor feels that it is not collecting all the G & A he is entitled to, he must be able to prove his claim by showing clearly that the direct settlement expenses do not also cover the claimed G & A expense. The case shows that the board findings will prevail if based on substantial evidence, and that the burden will be on the contractor to show that the record lacks substantial evidence to support the board's findings. "It is not the court's function to supply this deficiency by an independent excursion along the administrative trail."²⁵⁴ Thus, as for factual questions, the contractor would be well advised to go all out at the board level; if he can't convince the board of his position, it is doubtful the Court of Claims will be inclined to find a lack of substantial evidence and overrule the agency.

2. Profit on Subcontractor Settlements

The formula settlement expressed by the Termination for Convenience clause, subparagraph (e)(ii)(C), calls for a fair and reasonable profit in accordance with ASPR 8-303 on the costs allowed under subparagraph (e)(ii)(A), which are the costs incurred in the performance of the terminated work plus initial and preparatory expenses. The present ASPR 8-303 allows for profit on the preparation and work accomplished, but the amount of profit will not be based on the amount of the settlement expenses. This gives a different result from previous cases under the former ASPR 8-303²⁵⁵ where profit on settlement expenses was not allowed, and was interpreted to bar any profit on settlements with subcontractors.²⁵⁶

The rule for allowance of profit on subcontractor expense is expressed in ASPR 8-303(b)(viii):

The profit allowed for the contractor's efforts shall not be measured by the amount of the contractor's payment to subcontractors for settlement of their termination claims. The termination of a contract removes risks and responsibilities with respect to material or services which have not been delivered or furnished by the subcontractor. Therefore, no allowance to the prime contractor for profit may be made for such material or services which, as of the effective date of termination, have not been delivered by the subcontractor, regardless of the percentage of completion.

Thus, profit for subcontractor termination settlements is not allowed unless the material or services were furnished by the effective date of the termination. And the magnitude of profit will be based on factors outlined in ASPR 8-303,

for example the "effort in negotiating [the] settlement of terminated subcontracts,"²⁵⁷ and not the amount of the settlement with subcontractors.

An example of a case in which the contractor attempted to obtain an allowance from the board for profit on the amounts paid under a settlement agreement to subcontractors is Nolan Brothers.²⁵⁸ After the prime contract was terminated for convenience, the prime had terminated the subcontractors as he was required to do under the Termination for Convenience clause.²⁵⁹ The subcontractor claims were then settled, but since there was nothing to indicate that the settlements covered anything provided before the termination, the claim for profit on the settlements was denied.²⁶⁰ The Termination for Convenience clause, as written then and as stated now under subparagraph (e)(ii)(A) and (C) will not allow profit on contract work unless it was performed prior to the termination. This determination was not discussed or upset by the Court of Claims.²⁶¹

3. First Article Approval

The contractor is entitled to the costs incurred for settlements with subcontractors even in certain situations where the contractor does not abide by the provisions of the First Article Approval--Contractor Testing Clause,²⁶² which indicates that if the contractor acquires materials

or commences production prior to the first article approval, it will be at his own risk. The clause also explicitly states that this risk will remain the contractor's in the event of a termination for convenience.

However, where it is impossible to wait for first article approval in order to meet the production and delivery schedule, the contractor will not be required to meet the first article approval requirement.²⁶³ For instance, in Switlik Parachute Company, the contractor was allowed the costs of settlement with his subcontractors who were supplying him with the components of production before the first article was approved so that he could meet the delivery schedule.²⁶⁴

Atlas Fabricators²⁶⁵ is an example of a situation where the contractor was not able to avoid the consequences of the First Article Approval clause. The board found that the production materials acquired before first article approval would not be allocable to the contract upon termination since they were acquired at the contractor's risk and were not within the Young Metal Products²⁶⁶ exception (where it was impossible to comply with the delivery schedule unless orders for materials were made in advance of first article approval). The board found that the Termination Cost Principle which allows the cost of a subcontractor settlement does not override the First Article Approval clause, i.e., "[t]he fact that ASPR authorizes

allowance, in termination settlements, of the costs of subcontractor settlements, is not a basis for allowance . . . "267 of these costs when the First Article Approval clause is violated.

4. Judgment and Litigation Costs

One of the general rules regarding subcontractor settlements is that when a subcontractor sues the contractor, the legal fees incurred by the contractor in defending the suit and settling the subcontractor claim are allowable. This is normally a matter to be handled under ASPR 15-205.42(f) as a settlement expense, but it is sometimes not distinguishable from what is usually the more significant part of the claim, the subcontractor settlement under ASPR 15-205.42(g).

A case in which both of these costs are discussed together, as if there is no distinction, is Nolan Brothers v. United States,²⁶⁸ where the Court of Claims encountered a situation where the contractor terminated a subcontractor for default four months before he (the prime) was terminated for convenience. The subcontractor sued the prime contractor and won a judgment indicating that the subcontractor was not in default and that the prime had wrongfully breached the contract. The judgment, as well as court costs and attorneys fees, was claimed by the contractor and allowed by the board.

The board found that the action terminating the subcontract was "a matter of sound business judgment."²⁶⁹

This decision is perhaps remarkable because the Government attempted to rebut the sound business judgment conclusion by indicating that after the subcontract was terminated the contractor himself undertook the work. The contractor's expenses in completing the subcontract work were over \$210,000, although the subcontract price was only slightly more than \$18,000.²⁷⁰ However, the court found the board's conclusion that the contractor had a contract right to do the work and that his costs were reasonable was established by the record. The fact that someone else could do the work cheaper was not enough to show the completion costs were unreasonable. The result is that a judgment won by a subcontractor, even one arising from a wrongful termination for default, is an allowable subcontractor expense and it can include the cost of attorneys fees and court costs. As long as these attorneys fees and court costs are not also claimed as settlement expenses under ASPR 15-205.42(f), there is no problem with grouping them with ASPR 15-205.42(g) costs.

The importance of being able to show payment of a subcontractor claim, even after a judgment is awarded, is a necessity as the Remsel Industries²⁷¹ case shows. This case involved a situation where the contractor refused to accept or pay for the subcontractor's motors after the prime contract was terminated for default. The prime contract was later converted to a termination for convenience and the contractor asserted a claim against the Government which

included an amount for the subcontractor's claim. The board decided that even though the motors hadn't conformed strictly to the specifications, the claim was allowable because it was felt the contractor had acted reasonably in procuring the motors,²⁷² particularly since the Government knew the contractor was ordering the nonconforming motors, yet took no action to have the order cancelled. The contractor's claim was submitted for the cost of the motors including interest and attorneys fees; the legal fees, since they were reasonably incurred in defending against the subcontractor's claim, were allowed. But since there was no evidence the subcontractor claim had been paid, it was "premature" to settle and pay it.²⁷³ Thus, a contractor should be prepared to show he has actually paid off a claim, and not just engaged in a lawsuit or agreed to pay a subcontractor.

III. UNALLOWABLE COSTS

This section will briefly highlight two areas where improvement and change need to be made in the ASPR before a contractor can be made whole. Both of these cost categories have been mentioned to some extent above; however, it is felt these are the two primary considerations which need attention if there is to be a better measure of equity in termination settlements. These two areas are appeal costs and unabsorbed overhead.

A. Appeal Costs

There are probably many situations every year where the contracting officer makes termination settlement decisions which seem wrong and unfair in a patent manner even at the time they were made. Not only does the contractor have to undergo the frustration of facing an inadequate administrative decision of the contracting officer, but he has to face the fact that he will have to expend more time and money, and sometimes he can ill afford either expense, to wage an appeal to the board. Although the appeal is supposed to be only an administrative step, and one which theoretically should be fairly inexpensive and speedy, this is just not often enough the case. The board functions more and more as a court. It has its own procedures for brief filing,

hearings, and arguments; it publishes decisions which are sometimes voluminous, and its factual findings and even legal statements are in practice accorded substantial respect by the Court of Claims.

Because of all the complexity which has developed, a contractor cannot expect to be very successful with a termination claim unless he hires attorneys and accountants, develops significant amounts of documentation and data, and is prepared to meet what often appears to be a determined Government adversary at the board hearing. The contractor must be prepared to go all out for victory at the board hearing, if he hasn't already at the contracting officer level, because his only recourse after the board would be the Court of Claims, and this would represent an equally great, if not greater, expenditure in appellate counsel fees and time.

The need is for some relief to be given the contractor for the cost of his appeal to the board, at least in situations where the contractor is successful in the appeal. An example of a case which highlights this need is American Electric.²⁷⁴ In that case, the board specifically found that the TCO told the contractor during the time negotiations were stalemated that if the contractor could get the Air Force to agree with him on the assets part of the claim, he would decide favorably on that issue.

The contractor was successful in getting Air Force

approval for his position. The Deputy Assistant Secretary of the Air Force (Procurement) stated in writing that the Loss of Useful Value Cost Principle should apply. However, the TCO then refused to abide by this advice and issued a final decision to the contrary.²⁷⁵

One argument raised later by the contractor was that this refusal on the part of the TCO caused the contractor to incur substantial costs including the services of attorneys, accountants, three former employees and four corporate executives after the final decision in order to develop a successful appeal to the board. The board disallowed these costs since they were incurred in an effort to pursue a claim against the Government and rejected the argument that the TCO's arbitrariness caused these expenses.

In reply, the board cited Condec Corporation,²⁷⁶ a case dealing with an assertion that the DCAS Settlement Review Board had arbitrarily rejected an agreement between the contracting officer and the contractor; the board disposed of the issue of arbitrariness by stating, "[t]he risk of disagreement, whether termed 'arbitrary' or not by appellant, is a risk assumed at either Governmental level, the first or the last." Although this opinion may represent the board's belief, it seems that as a matter of policy it would be preferable to separate "arbitrariness" from "disagreement" since it can hardly be seriously urged that a Government contractor is assuming a risk of arbitrariness.

Perhaps the best solution would be to administratively change the ASPR so that settlement expenses including attorneys fees are allowed upon appeal should the contractor prevail, or at least allow the board the power to, in its discretion, award appeal and counsel costs in an amount proportionate to the percentage of the board's award.

As a suggestion, the contractor should at least be entitled to have the board award a share of the costs which bear a reasonable relation to the merits of the claim. For example, should the claimant prevail for only \$10,000 on a \$1 million claim, his award for appeal costs should be far less than if he were awarded \$875,000. The goal of such a compensatory scheme is that it would enable the contractor to be made whole for the reasonable costs incurred in successfully asserting his rights to recovery from the Government.

Such a compensatory scheme recognizes that the administrative resolution of disputes by the contracting officer is really a decision by one of the parties to what is essentially an adversary proceeding. The Government thus has held the upper hand not only in deciding when it wants to terminate for its convenience, but in being able to unilaterally decide the amount of compensation the contractor can collect without having to appeal. The contracting officer is in a unique position because he can unfairly deny the contractor his rightful settlement with

relative impunity because the board has failed to deal with the fact that arbitrariness, not just disagreement, may also give rise to appeals, and arbitrariness is not a risk bargained for by the contractor.

An allowance for appeal costs might be salutary as it would represent a balancing force that could make the contractor more of an equal party when he negotiates with the Government. Not only would one-sided settlements be less likely but there may be greater encouragement for the Government to be more flexible in its bargaining stand and thus contribute to more negotiated settlements.

But, in any event, the costs of appeal have risen to the point where it can be a major hardship on a contractor to assert his rights. Even winning 100 percent of the claim at the board level will not, under the present system, make the contractor whole since he cannot recover the costs of prosecuting a claim. This deficiency should be recognized and corrective action through the ASPR taken. Should inaction prevail, the contractor's fall-back position would be to attempt to provide for these costs in the contract or refuse to do Government business.

B. Unabsorbed Overhead

One of the problems frequently facing contractors and procurement officials is how to treat costs which cannot be absorbed after a termination. Often when a termination

occurs the contractor finds that the more expensive costs incurred to start or complete initial production, and which he planned to recover over the life of the contract as the cost of later production falls, will not be reimbursed by the contract price of the units he has completed before termination.

The subject of unabsorbed overhead has been mentioned several times above, but it was not fully asserted, there, that a possible injustice was being rendered when a contractor is not able to recover these costs. Yet, this can also be an important area of loss to the contractor and represent a significant departure from the goal of making the contractor whole. This is not always a problem in every termination, as appeal costs would be for every appeal, particularly since unabsorbed overhead is allowed in partial terminations for convenience. "In partial terminations for the Government's convenience, the Boards have consistently permitted recovery of unabsorbed overhead as part of an equitable adjustment to the price of the non-terminated items."²⁷⁷ However, "[t]o allow such costs in a partial termination, but to deny them in a complete termination would seem to be unfair and inconsistent."²⁷⁸

This inconsistency is all the more vexing to the contractor since there are some occasions where unabsorbed overhead has been allowed in complete terminations. Examples of such cases are Pamco Corporation;²⁷⁹ West Lumber Sales;²⁸⁰

and Sundstrand Turbo v. United States.²⁸¹ However, these cases all involved situations where facilities were built or leased solely for the contract; these costs were treated as direct costs which could continue for a time past the termination and still be allowable in the termination for convenience settlement, since they were found to be allowable as continuing costs under ASPR 15-205.42(b).

Despite these three exceptions, the board appears to be moving steadily away from allowing unabsorbed overhead after a complete termination, unless the contractor can essentially make the claim out to be one for direct costs, such as was done in the above three cases. Otherwise, the hope that was raised in Fairchild Stratos Corporation, which stated that, "we think there may be instances where allowance of unearned or unabsorbed dollar overhead would be appropriate,"²⁸² and tempered by Technology Incorporated, which stated that charging unabsorbed overhead to a terminated contract "would place the Government in the position of a guarantor of appellant's overhead,"²⁸³ is slowly dwindling after the Chamberlain Manufacturing Corporation²⁸⁴ case, which stressed that it is the contractor's obligation to recover or diminish its unabsorbed overhead by seeking out new business after the termination and not to claim this cost from the Government.

The Chamberlain case's levy of responsibility for

unabsorbed overhead on the pocket of the contractor signals the discouraging position the contractor is in as regards collecting a claim for unabsorbed overhead. The board's position completely overlooks the fact that the contractor in all probability was not anticipating a termination for convenience, and even if he were, it would not likely have been easy for him to have committed his resources elsewhere while he was still committed to performance of the Government contract.

If the contractor has made a reasonable attempt to fill the gap created by the Government's termination, it would not seem fair to deny the claim for unabsorbed overhead. For example, if the contractor's Government contract is being charged with 36 percent of his overhead, it would seem to be logical to allow the contractor this unabsorbed overhead (36 percent of his overhead costs) under ASPR 15-205.42(b) if he makes reasonable, but unsuccessful, efforts to seek new business or otherwise diminish his overhead.

The Chamberlain case demonstrates that the board will not consider unabsorbed overhead as being "directly" related to the terminated contract. Perhaps the board's weakness as to this viewpoint is that it does not really articulate any worthwhile reasons why it chooses to ignore its stated goal of making the contractor whole, when such a denial of unabsorbed overhead so obviously scuttles this purpose.

It apparently feels that the drafters of the ASPR would have specifically provided for such a recovery if they had intended it to be allowable. As it was mentioned earlier, this reasoning may seem superficially convincing, but it just does not apply to the Termination Cost Principles since, as in the case of ASPR 15-205.42(b) concerning continuing costs, the language employed is so general that it could make most any cost allowable as long as it cannot be discontinued immediately after the effective date of the termination.

There is neither a direct statement nor any reasonable implication in all of ASPR 15-205.42 which indicates that unabsorbed overhead is not allowable. This interpretation is strictly an invention of the board. Because the language used in the Termination Cost Principles indicates the goal is to compensate, not deny, the contractor for the after-effects of the termination, it would appear that unabsorbed overhead should have been specifically mentioned in these principles only if it were intended not to be allowed.

The board also indicates that to guarantee a contractor's overhead would constitute a "penalty" to the Government for exercising its contractual rights to terminate for convenience.²⁸⁵ This view, however, overlooks the significance of the Government's right to terminate for convenience, which is still intact; the only change is that payment for unabsorbed overhead would keep the contractor from being

penalized by not being able to recoup the overhead costs unrecovered because the Government exercised its right to terminate.

The Government's argument that it would be penalized because it would obtain no corresponding benefit from allowing this as a continuing cost is not an overwhelming argument, particularly since it already derives no "benefit" from most of the Termination Cost Principles, e.g., loss of useful value, rental costs, settlement expenses, and initial costs. If the board wishes to make the contractor whole, it can hardly accomplish this goal without attaching some Government responsibility for unabsorbed overhead allocable to the contract.

The board's final conclusion in Chamberlain Manufacturing Corporation does give some hope that the struggle for the allowability of unabsorbed overhead after a complete termination is not completely lost. Its very last comment indicates that the decision in the case is also based on the facts established in the record. It states, "[p]lainly, however, appellant has not proved that the increase resulted entirely from the termination nor that, at least in part, the overhead claimed was not recovered in the prices of new fixed-price business."²⁸⁶ Thus, the contractor may well have a chance of collecting an award for unabsorbed overhead if he can make a convincing factual showing that there was an increase in overhead rates which was directly related to

the termination,²⁸⁷ and that these costs were not recovered from new business nor otherwise diminishable. Otherwise, relief for the cost of unabsorbed overhead will probably not be consistently available until there is a change in the Termination for Convenience clause, ASPR, Section XV, or both.

IV. CONCLUSION

There are many possible recommendations which could be made based on the preceding discussion of the ASPR 15-205.42 Termination Cost Principles, particularly since it is simply impossible to provide in advance by regulation for the many various factual situations which may be involved in a termination for convenience settlement. The present overall direction achieved by ASPR 15-205.42 is most likely a preferable solution to further additions of detailed cost principles since the current regulations attempt to lay down general ground rules for the allowability of costs, and they recognize the need for a "special treatment of costs, which would not have arisen had the contract not been terminated." Thus, even though there may be some problems caused by the fact that these seven cost principles are not entirely comprehensive or clear, as long as the contracting officer and board are guided by the recognition that a termination for convenience is a special power which enables the contract to be terminated without the fault or negligence of the contractor, and that these costs caused by the termination would not otherwise have been incurred (such as settlement costs) or unrecovered (as in the case of initial costs which would have been recovered in the contract price

had the contract been completed), the cost principles of ASPR 15-205.42 should normally be capable of making the contractor whole (with the exception of appeal costs) for the consequences of the Government's exercise of its termination power.

The difficulty is, as was brought out above in the discussion of a representative sample of the significant termination for convenience settlement decisions, that the contracting officer and the board do not often enough implement these cost principles so as to achieve the objective of making the contractor whole. Sometimes, the problem is more or less the responsibility of the contractor. In order to recover his allowable costs the contractor has to be able to show that (a) the cost is allowable under the regulations, (b) it was in fact incurred, and (c) it is reasonable in amount.

These latter two requirements are really contractor responsibilities which can by and large be resolved through such methods as having an accounting system designed to identify the costs of a termination, e.g., continuing costs and settlement expenses. Such an accounting system will be beneficial not only for clear cost identification purposes, but it will also help avoid the objection that costs are really allocable to other work. In addition, the contractor should be aware of the need to have time and expense logs kept for the work performed on the termination, particularly

by his key personnel, as well as the attorneys, accountants, and clerical personnel working on the settlement.

In the decisional material it appeared that if record keeping effort was expended the contractor typically did not have difficulty surviving challenges as to questions of how much effort had been incurred on the termination. But where the contractor had to rely on such evidence as his employees' testimony from memory at the board hearing, there were often problems establishing these costs. The Government also seemed to be somewhat more successful raising the issue of reasonableness if there was a lack of documentation to support the claim. However, the reasonableness test was normally not a major hurdle to the contractor since he had the benefit of his "business judgment" as a standard to support the incurrence of most costs; additionally, there seemed to be a tendency not to find a cost unreasonable unless it was "patently" unreasonable. The Government normally had difficulty proving unreasonableness unless, for example, it was able to show that the cost was incurred to support a claim which was specifically unallowable, such as for anticipatory profits.

It remains that the major obstacle which the contractor must surmount is to show that the claimed cost is allowable under the regulations. No matter how effective his accounting and record keeping system is, and no matter how reasonable it is to incur the cost, if he cannot show that the cost is

allowable under the contract or the cost principles, he will not be able to recover them. This has perhaps been the most difficult problem for the contractor since there is very little he can do if the contracting officer does not agree that a cost is allowable. If an acceptable negotiated settlement cannot be worked out, the contractor must appeal to the board.

The board appears to be generally favorable to the contractor in regards to problems of actually proving the incurrence of costs, since it will accept oral evidence and occasionally does appear to follow the philosophy expressed in ASPR 8-301(c) indicating that "[t]he amount of record keeping, reporting and accounting, in connection with the settlement of termination claims shall be kept to the minimum compatible with the reasonable protection of the public interest."

The cases in which the contractor failed in terms of a presentation of factual proof are not unusual, but they seemed to involve extraordinarily inept or half-hearted attempts to support a claim, and the board often appeared to have genuinely wished to have found for the contractor if only it had been afforded some degree of rational evidence. As far as the challenges to reasonableness of costs are concerned, this has been an area where the board has been perhaps even more favorable to the contractor than in the area of proof of the incurrence of costs. The contractor

has seldom had difficulty unless the expenses were related to a specifically unallowable claim, or involved situations where a gross overstatement of work was claimed as compared to the actual output produced.

The board, however, has not been particularly favorable to expansions of the Termination Cost Principles in order to pay a claim which is not specifically allowable. There was one situation where it resorted to ASPR 15-201 to find a cost allocable and reasonable, but normally it read the remainder of ASPR Section XV, Part 2, to limit the allowability of the termination costs which were not expressly allowable under ASPR 15-205.42.

This is somewhat surprising in view of the board's recurring statement that its purpose is to make the contractor whole. Two of the most important areas in which this purpose has not been achieved are the disallowance of appeal costs and the inconsistent treatment of unabsorbed overhead. The allowability of appeal costs will most likely require an ASPR change since it is fairly certain that the board does not have sufficient latitude within either the language of the Termination for Convenience clause or the ASPR cost principles to allow these costs. The board never mentions or expresses any recognition that the failure to allow appeal costs is inconsistent with the purpose of making the contractor whole. It is sometimes difficult to believe that the board will not at least recognize that the present situation represents an

unjust situation for the contractor, particularly since he is forced to appeal a decision made by his adversary in the negotiations. The Government derives benefit from being able to deny the contractor's claim and effect a unilateral decision. The contractor, since he must appeal to redress his rights, should be able to recover the costs of a successful appeal as a counterbalance to the advantage the Government has at the contracting officer level in the resolution of the claim.

As far as unabsorbed overhead is concerned, the situation is somewhat different since the board does have adequate language in the Continuing Cost Principle to find that these costs are allowable. Unabsorbed overhead has been found to be allowable after partial terminations for convenience and in some complete terminations where continuing facility costs were termed direct costs and thus made allowable. But unabsorbed overhead is not specifically allowable after a complete termination; hence, it would behoove the board to explain more fully why it is drawing a line on allowability of these costs and how such a denial comports with the goal of making the contractor whole.

The board has not really addressed these questions at all since in virtually every unabsorbed overhead case involving a complete termination it concludes with a passage stating that the contractor failed to factually prove his claim. Thus, there is still doubt as to how the issue of

unabsorbed overhead will be finally resolved; however, it is suggested that a contractor, if he has the opportunity to litigate this question, couch his claim for unabsorbed overhead in an argument that the board's purpose of making the contractor whole will be unfulfilled unless these costs are allowed, and that the ASPR 15-205.42 philosophy of giving "special" treatment to costs after a termination also requires such allowability.

A favorable board decision on unabsorbed overhead would represent an elevation in the role of the Termination Cost Principles as opposed to the remainder of the ASPR Section XV Cost Principles. As it is now, if the board does not find specific guidance in ASPR 15-205.42, it looks uncritically to the rest of the ASPR Section XV Cost Principles for a solution. The result has been that sometimes the treatment of costs originates from these other cost principles despite their inconsistency with ASPR 15-205.42 and the defeat of the purpose of making the contractor whole. But the allowance of unabsorbed overhead, which is nowhere mentioned in the cost principles, would represent a reversal of this tendency to go outside the Termination Cost Principles since this would essentially entail a recognition that the Termination Cost Principles are unique and were developed to address a special situation which is different from the purpose served by the other cost principles.

Thus, decisions regarding allowable termination costs

should originate from the philosophy of compensating a contractor for the costs resulting from the Government's exercise of its termination power; the Termination Cost Principles are broadly stated and as long as the allowance of a cost will be consistent with the philosophy of compensating the costs caused or unrecovered because of the termination, it should be allowed whether or not the cost is specifically mentioned in the broad language of ASPR 15-205.42. The end result should be the development of a consistent pattern of making the contractor whole, and this is the type of certainty which the contractor is entitled to expect when he makes his claim for a convenience termination settlement.

FOOTNOTES

1. United States v. Corliss Steam-Engine Co., 91 U.S. 321 (1875). Even though there was no express contract clause allowing for termination, the Government was allowed to terminate the contract for the public interest and then negotiate a binding settlement.
2. Moss & Gantt, "A Steam Engine and Contract Termination Procedures," 8 Public Contract Law Journal 188, Dec. 1976.
3. United States v. Speed, 8 Wall 77 (1868).
4. Hardee, "Termination of Military Contracts," 32 Texas L. Rev. 172, 173 (1953).
5. Contract Settlement Act of 1944, 41 U.S.C. § 101 et seq. (1965).
6. Hardee, supra note 4, at 175.
7. Dounis & Foreman, "Historical Significance of Termination of Contracts for the Convenience of the Government," 14 Fed. Bar Journal 191, 208, July-Sept. 1954.
8. Armed Services Procurement Act of 1947, 10 U.S.C. § 2301-14 (1974).
9. Armed Services Procurement Regulations, 32 CFR 1.100 et seq. (1976), cited herein as ASPR.
10. ASPR 7-103.21 (1974 Oct.) is the current mandatory Termination for Convenience of the Government clause for use in fixed-price supply contracts.
11. G.L. Christian & Assocs. v. United States, 312 F.2d 418 (Ct. Cl. 1963), motion for reconsideration denied, 320 F.2d 345, (Ct. Cl. 1963), cert. denied, 375 U.S. 954 (1963).
12. ASPR 7-103.21(a).
13. ASPR 7-103.21(e) (ii) (C).
14. ASPR 7-103.21(b) (i)-(ix).
15. Brous, "Termination for Convenience: A Remedy for the Erroneous Award," 5 Public Contract Law Journal 221, Oct. 197

16. Federal Procurement Regulations, 41 CFR, Chap. 1 (1976), cited herein as FPR.
17. G. Cuneo, Government Contracts Handbook 127 (1962).
18. Dounis & Foreman, supra note 7, at 208.
19. P. Truegar, Accounting Guide for Defense Contracts (6th ed. 1971), at 875.
20. ASPR 8-214.
21. ASPR 7-103.21(f).
22. Lazure, "The Defense Department Termination Clause Impact on Contractors: A Problem in Contractual Differential Calculus," 14 Federal Bar Journal 213, 223 July-Sept. 1954.
23. ASPR 7-103.21(e).
24. Armed Services Board of Contract Appeals, herein referred to as ASBCA or the board.
25. Gantt, "Termination in Federal Government Contracts," 7 William and Mary L. Rev. 225 (1966).
26. Mitchell, "Termination of Government Contracts: Recent Developments," 14 William and Mary L. Rev. 817, 874 Summer 1973.
27. ASPR 8-301(b): "The primary objective is to negotiate a settlement by agreement. The parties may agree upon a total amount to be paid the contractor without agreeing on or segregating the particular elements of cost or profit comprising this amount."
28. Wienshienk & Feldman, "The Current Challenge of Military Contract Terminations," 66 Harv. L. Rev. 47, 51 (1952).
29. Carhart, "The Relationship Between Termination of Policies and Contract Law," at 3, Rand Paper Series, Aug. 1975.
30. Petit, "Post-Termination Costs," Briefing Papers # 73-3, at 1, Federal Publications (1973).
31. Wienshienk & Feldman, supra note 28, at 56, which states, "[t]his is not the place to attempt an exhaustive consideration of what types of contractor expense should be reimbursed upon termination."

32. ASPR 15-205.42, also cited herein as the Termination Cost Principles.
33. E.g., ASPR 7-103.21.
34. ASPR 7-103.21(f): "Costs claimed, agreed to, or determined pursuant to (c), (d), (e), and (i) hereof shall be in accordance with § XV of the Armed Services Procurement Regulations as in effect on the date of this contract."
35. ASPR 7-103.21(d).
36. ASPR 7-103.21(c).
37. ASPR 8-210.5.
38. See G.L. Christian & Assocs. v. United States, supra note 11 at 423, "The Government concedes that the claimants are entitled to be made financially whole, at least with respect to all reasonable expenses that they incurred in preparing to perform work under the Fort Polk housing contract . . . "; American Machine & Foundry Co., ASBCA No. 8862, 65-1 BCA 4654, at 22,247: "the overriding objective remains in essence to make the contractor financially whole for all of the direct consequences of the Government's exercise of its extraordinary reserved power to terminate performance, excepting the loss of anticipated profits on work not performed;" American Electric Inc., ASBCA No. 16635, 76-2 BCA 12,151 at 58,481, "we must remember that in termination for convenience circumstances the goal is to make the contractor financially whole, at least insofar as reasonably incurred costs are concerned."
39. Wright, "Special Consideration in Accounting for Terminated Defense Contracts," 16 Federal Accountant, 38, 42, Nov. 1967.
40. ASPR 7-103.21(f).
41. ASPR 15-205.42(a).
42. Colonial Metals Co., ASBCA No. 15860, 72-1 BCA 9328.
43. Colonial Metals Co. v. United States, 495 F.2d 1355 (Ct. Cl. 1974).
44. E.g., ASPR 7-103.21(b)(viii).
45. ASPR 8-706.
46. Colonial Metals Co., supra note 33, at 43,258.

47. Colonial Metals Co., supra note 33, at 43, 259.
48. ASPR 15-205.42(g).
49. Codex Corp., ASBCA No. 17983, 74-2 BCA 10,827; aff'd on reconsideration, 75-2 BCA 11,554.
50. Id., 75-2 BCA 11,554, at 55,154-55.
51. Id., at 55,151-52. The three cited cases were: Dunlap & Assocs., Inc., ASBCA No. 4903, 59-2 BCA 2277; General Electric Co., ASBCA No. 4865, 60-2 BCA 2705; North American Rockwell Corp., ASBCA No. 15863, 72-2 BCA 9490.
52. Codex Corp., 75-2 BCA 11,554, supra note 49, at 55,154.
53. Southland Mfg. Corp., ASBCA No. 16830, 75-1 BCA 10,994; 75-1 BCA 11,272.
54. Id., 75-1 BCA 10,994, at 52,357.
55. Baifield Indus., ASBCA 20006, 76-2 BCA 12,096; 76-2 BCA 12,203.
56. Id., 76-2 BCA 12,096, at 58,092, citing Chamberlain Mfg. Co., ASBCA No. 16877, 73-2 BCA 10,139.
57. Baifield Indus., 76-2 BCA 12,096, supra note 55, at 58,093.
58. McBride & Wachtel, 4A Cyclopedic Guide to Law, Admin. and Procedure on Government Contracts, § 30, at 30-164 (1976).
59. Baifield Indus., 76-2 BCA 12,096, supra note 55, at 58,093.
60. American Electric, Inc., ASBCA No. 16635, 76-2 BCA 12,151, at 58,497.
61. Id., at 58,517-18.
62. R-D Mounts, Inc., ASBCA Nos. 17422, 17668, 17669, 75-1 BCA 11,077.
63. American Electric, Inc., supra note 60, at 58,517.
64. Truegar, supra note 19, at 881.
65. Petit, supra note 30, at 3.
66. Chamberlain Mfg. Co., ASBCA No. 16877, 73-2 BCA 10,139.

67. Id., at 47,678.
68. Id., at 47,679.
69. Technology Inc., ASBCA No. 14083, 71-2 BCA 8956; aff'd on reconsideration, 72-1 BCA 9281.
70. Fairchild Stratos Corp., ASBCA No. 9169, 67-1 BCA 6225; aff'd on reconsideration, 68-1 BCA 7053.
71. Technology Inc., 71-2 BCA 8956, supra note 69, at 41,630-31.
72. Fairchild Stratos Corp., supra note 70, at 28,799.
73. Nolan Bros. v. United States, 432 F.2d 1371 (Ct. Cl. 1971).
74. Technology Inc., 71-2 BCA 8956, supra note 69, at 41,631.
75. Id., at 41,631.
76. Id., at 41,631.
77. Id., at 41,631.
78. Pamco Corp., ASBCA No. 3114, 57-2 BCA 1489; West Lumber Sales, ASBCA No. 10879, 67-1 BCA 6101; and Sundstrand Turbo v. United States, 389 F.2d 486 (Ct. Cl. 1968).
79. Technology Inc., 72-1 BCA 9281, supra note 69, at 43,007.
80. Chamberlain Mfg. Corp., supra note 66, at 47,678.
81. Id., at 47,679.
82. Id., at 47,679.
83. Id., at 47,679.
84. R-D Mounts, Inc., supra note 62.
85. Id., at 52,739.
86. R-D Mounts, Inc., ASBCA Nos. 14827, 14863, 14864, 14999, 15071, 15358, 71-1 BCA 8643, aff'd on reconsideration, 71-1 BCA 8725.
87. See Douglas Corp., ASBCA No. 14998, 70-1 BCA 8338; Tuason Const. Co., ASBCA No. 5106, 59-1 BCA 2266.
88. Southland Mfg. Corp., 75-1 BCA 10,994, supra note 53.

89. Codex Corp., 75-2 BCA 11,554, supra note 49.
90. Id., at 55,154.
91. Codex Corp., 75-2 BCA 11,554, supra note 49, at 55,151.
92. Codex Corp., 74-2 BCA 10,827, supra note 49, at 51,497.
93. Id., at 51,498.
94. Wright, supra note 39, at 41.
95. Baifield Indus., supra note 55.
96. Atlas Fabricators, ASBCA No. 16426, 72-1 BCA 9263.
97. Young Metal Products, ASBCA No. 15701, 71-1 BCA 8827.
98. Collins Electronics, Inc., ASBCA No. 16026, 72-1 BCA 9236.
99. Id., at 42,830.
100. ASPR 8-301(c).
101. Collins Electronics, Inc., supra note 98.
102. Bldg. Maintenance Specialists, Inc., DOTCAB # 71-4, 71-2 BCA 8954.
103. E.g., FPR 1-15.205-42(c), which is identical to ASPR 15-205.42(c).
104. G.L. Christian & Assocs. v. United States, supra note 11.
105. T.C. Bateson Const. Co. v. United States, 319 F.2d 135 (Ct. Cl. 1963).
106. American Packers, Inc., ASBCA No. 14275, 71-1 BCA 8846.
107. ASPR 8-307.2(a).
108. ASPR 8-307.2(b).
109. Douglas Corp., ASBCA No. 5550, 60-1 BCA 2531.
110. Wright, supra note 39, at 41.
111. ITT Defense Comm. Div., ASBCA Nos. 11858, 13439, 70-2 BCA 8415.
112. Id., at 39,163. See also Ted J. Grimsrud, ASBCA No. 7971, 1962 BCA 3562 and Navgas, Inc., ASBCA No. 9240, 65-1 BCA 4533.

113. E.g., ASPR 7-103.21(a).
114. Precision Switch Corp., ASBCA No. 13986, 69-2 BCA 8012.
115. Sternberger v. United States, 401 F.2d 1012 (Ct. Cl. 1968).
116. Id., at 540.
117. Id., at 533.
118. Anthony M. Meyerstein, Inc. v. United States, 135 Ct. Cl. 764 (1956).
119. Id., at 770.
120. Continental Electronics Mfg. Co., ASBCA No. 14749, 71-2 BCA 9108.
121. Id., at 42,208.
122. Id., at 42,209.
123. R-D Mounts, Inc., supra note 62.
124. Id., at 52,737.
125. Id., at 52,737.
126. ASPR 15-205.42.
127. ASPR 15-205.42(c)(i).
128. Pamco Corp., supra note 78.
129. Id., at 5126.
130. Id., at 5126.
131. ASPR 8-101.21.
132. American Electric, Inc., supra note 60, at 58,481.
133. Id., at 58,482.
134. L.B. Smith, Inc., ASBCA No. 2358, 61-1 BCA 2998, at 15,568, cited in American Electric, Inc., supra note 60, at 58,482.
135. H. Wright, Accounting for Defense Contracts (1962), cited in American Electric, Inc., supra note 60, at 58,482.
136. Southland Mfg. Corp., 75-1 BCA 10,994, supra note 53, at 52,355.

137. American Electric, Inc., supra note 60, at 58,483.
138. Id., at 58,481.
139. K & M Const. Co., ENG BCA No. 3542, 76-1 BCA 11,847.
140. Id., at 56,656.
141. Southland Mfg. Corp., 75-1 BCA 11,272, supra note 53.
142. Id., at 53,735.
143. Aerojet General Corp., ASBCA Nos. 15703, 15704, 73-1 BCA 9932.
144. Id., at 46,594-95.
145. Id., at 46,595.
146. Allied Materials & Equip. Co., ASBCA No. 17318, 75-1 BCA 11,150.
147. Id., at 53,095.
148. ASPR 15-205.42(e).
149. ASPR 15-205.42(e)(i).
150. American Electric, Inc., supra note 60.
151. Id., at 58,458.
152. Id., at 58,484.
153. Id., at 58,484-85.
154. Pamco Corp., supra note 78.
155. Southland Mfg. Corp., 75-1 BCA 10,994, supra note 53.
156. American Electric, Inc., supra note 60, at 58,484.
157. Southland Mfg. Corp., 75-1 BCA 10,994, supra note 53, at 52,362.
158. Sundstrand Turbo v. United States, supra note 78.
159. Sundstrand Turbo, ASBCA No. 9112, 65-1 BCA 4653.
160. Sundstrand Turbo v. United States, supra note 78, at 47.
161. Legislative Resources, Inc., DCAB No. OMBE-16-74, 76-2 BCA 11,951.

162. Baifield Indus., supra note 55, at 58,092.
163. Id., at 58,092.
164. Id., at 58,088.
165. ASPR 15-205.12(b).
166. Southland Mfg. Corp., 75-1 BCA 10,994, supra note 53.
167. Id., at 52,354.
168. Id., at 52,355.
169. R-D Mounts, Inc., supra note 62, at 52,741.
170. Nolan Bros. v. United States, supra note 73, at 31.
171. Nolan Bros., ENG BCA No. 2680, 67-1 BCA 6095.
172. Lioudas (In re Argus Indus.), ASBCA No. 12829, 71-2 BCA 9015.
173. Id., at 41,883.
174. American Electric, Inc., supra note 60, at 58,503.
175. Id., at 58,526.
176. Id., at 58,527.
177. Engineered Systems, Inc., ASBCA No. 18241, 74-1 BCA 10,492, at 49,643; See also Codex Corp., 74-2 BCA 10,827, supra note 39, at 51,499.
178. Baifield Indus., 76-2 BCA 12,096, supra note 55, at 58,104.
179. Baifield Indus., ASBCA Nos. 14582 and 14583, 72-2 BCA 9676 (1972).
180. Baifield Indus., 76-2 BCA 12,096, supra note 55; see also Cyro-Sonics, Inc., ASBCA No. 13219, 70-1 BCA 8313 (1970).
181. American Packers, Inc. supra note 106.
182. Baifield Indus., 76-2 BCA 12,096, supra note 55, at 58,107.
183. Baifield Indus., 76-2 BCA 12,203, supra note 55, at 58,756-57.
184. Baifield Indus., 76-2 BCA 12,096, supra note 55, at 58,109.

185. Baifield Indus., 76-2 BCA 12,203, supra note 55 at 58,757.
186. Baifield Indus., 76-2 BCA 12,096, supra note 55, at 58,108.
187. H & J Const. Co., ASBCA No. 18521, 76-1 BCA 11,903.
188. Id., at 57,085.
189. Dairy Sales Corp., ASBCA no. 20193, 75-2 BCA 11,613.
190. E.g., see Topeka Janitor Serv., ASBCA No. 9989, 65-2 BCA 4911.
191. Switlik Parachute Co., ASBCA No. 18024, 75-2 BCA 11,434.
192. Id., at 54,437.
193. Citing McClockey & Co. v. Army, Office of Contract Settlement Appeal Board No. 277, 4 CCF ¶ 60,901 (1950). However, this case was found to be inapposite as it involved a contractor employee who happened to be a lawyer, but was not performing legal duties.
194. Switlik Parachute Co., supra note 191, at 54,446.
195. R-D Mounts, Inc., supra note 62.
196. Id., see also Southland Mfg. Corp., 75-1 BCA 10,994, supra note 53.
197. Nolan Bros. v. United States, supra note 73.
198. R-D Mounts, Inc., supra note 62, at 52,743.
199. Liodas (In re Argus Indus.), supra note 172.
200. Id., at 41,883.
201. Cyro-Sonics, Inc., supra note 180.
202. Id., at 38,658.
203. Id., at 38,658.
204. Id., at 38,660.
205. American Packers, Inc., supra note 106.
206. Id., at 41,130.
207. Douglas Corp., ASBCA 8566, 69-1 BCA 7578.

- 208. Acme Process Equip. Co. v. United States, 347 F.2d 538, 545-46 (Ct. Cl. 1965).
- 209. Id., at 546, note 8.
- 210. Sundstrand Turbo, supra note 159, at 22,229.
- 211. See, e.g., United States v. Chemical Foundation, 272 U.S. 1, 20 (1926); United States v. Thayer-West Point Hotel Co., 329 U.S. 585 (1947); Piggly Wiggly Corp. v. United States, 112 Ct. Cl. 391, 432 (1949); 28 U.S.C. 2516(a).
- 212. American Electric, Inc., supra note 60.
- 213. Baifield Indus., 76-2 BCA 12,096, supra note 55.
- 214. Id., at 58,103; see also Kamen Soap Prod. Co., ASBCA No. 2587, 57-2 BCA 1366, and Western States Painting Co., ASBCA No. 13843, 69-1 BCA 7616.
- 215. Baifield Indus., 76-2 BCA 12,096, supra note 55.
- 216. Id., at 58,112.
- 217. Dairy Sales Corp., supra note 189.
- 218. Id., at 55,455.
- 219. Engineered Systems, Inc., supra note 177.
- 220. Id., at 49,643.
- 221. Id., at 49,643.
- 222. Cyro-Sonics, Inc., supra note 180.
- 223. Baifield Indus., 76-2 BCA 12,096, supra note 55, at 58,104.
- 224. American Electric, Inc., supra note 60.
- 225. Id., at 58,498-502.
- 226. Wright, supra note 39, at 42.
- 227. ASPR 7-104.82.
- 228. Mintz, "The 'Rule of Necessity' Makes Its Impact Felt," The Washington Post, 5 July 1977, at A4. The article mentions a suit brought by 140 federal judges who alleged they were unconstitutionally deprived of their pay in real dollars by the 34.4% inflation occurring during a 6-1/2 year period ending 1 Oct. 1975.

- 229. Baifield Indus., 76-2 BCA 12,096, supra note 55 at 58,114.
- 230. Codex Corp., 74-2 BCA 10,827, supra note 49.
- 231. Id., at 51,499.
- 232. Liondas (In re Argus Indus.) supra note 172.
- 233. ASPR 15-205.31.
- 234. Cyro-Sonics, Inc., supra note 180.
- 235. Id., at 38,661.
- 236. Kinn Elect. Corp., ASBCA No. 16440, 72-1 BCA 9288, at 43,030, citing Power Equip. Corp., ASBCA No. 5904, 1964 BCA 4025.
- 237. American Electric Inc., supra note 60, at 58,522.
- 238. Id., at 58,522.
- 239. Q.V.S. Inc., ASBCA No. 7513, 1963 BCA 3699.
- 240. Switlik Parachute Co., supra note 191.
- 241. Id., at 54,443.
- 242. Nolan Bros. Inc., supra note 171, at 28,222.
- 243. Baifield Indus., 76-2 BCA 12,096, supra note 55, at 58,117, citing Allied Materials & Equip., supra note 146, and Thiokol Chem., ASBCA No. 17544, 76-1 BCA 11,731.
- 244. Petit, supra note 30, at 3: "There may be some question as to whether such costs should be classified (1) as 'continuing costs' of termination or (2) as 'settlement expenses' . . . [t]his distinction is important because . . . normal overhead charges can be added to 'continuing costs' but cannot be added to 'settlement expenses.'"
- 245. Wright, supra note 39, at 46.
- 246. Magnavox Co., ASBCA No. 17455, 74-1 BCA 10,495, at 49,696.
- 247. Colonial Metals Co., supra note 42.
- 248. Stewart Avionics, Inc., ASBCA No. 10463, 65-2 BCA 5214, at 24,070.
- 249. Baifield Indus., 76-2 BCA 12,096, see note 243.

- 250. Thiokol Chem. Corp., supra note 243, at 55,942.
- 251. American Electric, Inc., supra note 60.
- 252. Bolinders Co., ASBCA 5740, Army Appeals Panel, 60-2 BCA 2746 at 14,017-18. The G & A was allowed on the direct expense of the contract work performed in the sub-contractor's plants. The board decided that it made no difference that the inventory produced was never shipped to the contractor's plant.
- 253. Sundstrand Turbo v. United States, supra note 78.
- 254. Id., at 59.
- 255. E.g., ASPR 8-303 (1 Jan. 1969).
- 256. E.g., Thiokol Chem. Corp., supra note 243, at 55,944.
- 257. ASPR 8-303(b)(viii) (30 July 1976).
- 258. Nolan Bros., supra note 171.
- 259. E.g., ASPR 7-103.21(b)(iii).
- 260. Nolan Bros., supra note 171, at 28,225.
- 261. Nolan Bros. v. United States, supra note 73.
- 262. ASPR 7-104.55 (1969 Sept.).
- 263. Switlik Parachute Co., supra note 191; citing Young Metal Products, Inc., ASBCA No. 15701, 71-1 BCA 8827, at 41,033-34; cf. Atlas Fabricators, Inc., ASBCA No. 16426, 72-1 BCA 9263 at 42,946; Avco Corp., ASBCA No. 15252, 73-1 BCA 9958, at 46,723-24.
- 264. Switlik Parachute Co., supra note 191, at 54,446.
- 265. Atlas Fabricators, supra note 96.
- 266. Young Metal Products, supra note 97.
- 267. Atlas Fabricators, supra note 96, at 42,947.
- 268. Nolan Bros. v. United States, supra note 73 at 37-40.
- 269. Id., at 40.
- 270. Nolan Bros v. United States, supra note 73, at 40.

271. Remsel Indus., Inc., ASBCA No. 8462, 1963 BCA 3918.
272. Id., at 19,446.
273. Id., at 19,447.
274. American Electric, Inc., supra note 60.
275. Id., at 58,462-63.
276. Condec Corp., ASBCA 14234, 73-1 BCA 9808.
277. Petit, supra note 30, at 5.
278. Id., at 5.
279. Pamco Corp., supra note 78.
280. West Lumber Sales, supra note 78.
281. Sundstrand Turbo v. United States, supra note 78.
282. Fairchild Stratos Corp., 67-1 BCA 6225, supra note 70, at 28,798.
283. Technology Inc., supra note 69, at 41,631.
284. Chamberlain Mfg. Corp., supra note 66.
285. Id., at 47,679.
286. Id., at 47,679.
287. Petit, supra note 30, at 4.

SOURCES CONSULTED

Cases

Acme Process Equipment Co. v. United States, 347 F.2d 538
(Ct. Cl. 1965).

T.C. Bateson Construction Co. v. United States, 319 F.2d 135
(Ct. Cl. 1963).

G.L. Christian & Associates v. United States, 312 F.2d 418
(Ct. Cl. 1963); motion for reconsideration denied,
320 F.2d 345 (Ct. Cl. 1963), cert. denied, 375 U.S.
954 (1963).

Colonial Metals v. United States, 495 F.2d 1355 (Ct. Cl. 1974).

Anthony M. Meyerstein, Inc. v. United States, 135 Ct. Cl. 764
(1956).

Nolan Brothers v. United States, 432 F.2d 1371 (Ct. Cl. 1971).

Piggly Wiggly Corp. v. United States, 112 Ct. Cl. 391 (1949).

Sternberger v. United States, 401 F.2d 1012 (Ct. Cl. 1968).

Sundstrand Turbo v. United States, 389 F.2d 486 (Ct. Cl. 1968).

United States v. Chemical Foundation, 272 U.S. 1 (1926).

United States v. Corliss Steam-Engine Co., 91 U.S. 321 (1875).

United States v. Speed, 8 Wall. 77 (1868).

United States v. Thayer-West Point Hotel Co., 329 U.S. 585 (1947).

Boards of Contract Appeals Decisions

Aerojet General Corp., ASBCA Nos. 15703, 15704, 73-1 BCA 9932.

Allied Materials & Equipment Co., ASBCA No. 17318, 75-1
BCA 11,150.

American Electric, Inc., ASBCA No. 16635, 76-2 BCA 12,151.

American Machine & Foundry Co., ASBCA No. 8862, 65-1 BCA 4654.

American Packers, Inc., ASBCA No. 14275, 71-1 BCA 8846.

Atlas Fabricators, ASBCA No. 16426, 72-1 BCA 9263.

Avco Corp., ASBCA No. 15252, 73-1 BCA 9958.

Baifield Industries, ASBCA No. 20006, 76-2 BCA 12,096; 76-2
BCA 12,203.

Bolinders Co., ASBCA No. 5740, Army Appeals Panel, 60-2 BCA
2746.

Building Maintenance Specialists, Inc., DOTCAB No. 71-4,
71-2 BCA 8954.

Chamberlain Mfg. Co., ASBCA No. 16877, 73-2 BCA 10,139.

Codex Corp., ASBCA No. 17983, 74-2 BCA 10,827; motion for
reconsideration denied, 75-2 BCA 11,554.

Collins Electronics Inc., ASBCA No. 16026, 72-1 BCA 9236.

Colonial Metals Co., ASBCA No. 15860, 72-1 BCA 9328.

Condec Corp., ASBCA No. 14234, 73-1 BCA 9808.

Continental Electronics Mfg. Co., ASBCA No. 14749, 71-2
BCA 9108.

Cyro-Sonics, Inc., ASBCA No. 13219, 70-1 BCA 8313.

Dairy Sales Corp., ASBCA No. 20193, 75-2 BCA 11,613.

Douglas Corp., ASBCA No. 5550, 60-1 BCA 2531.

Douglas Corp., ASBCA No. 8566, 69-1 BCA 7578.

Douglas Corp., ASBCA No. 14998, 70-1 BCA 8338.

Dunlap & Assocs., Inc., ASBCA No. 4903, 59-2 BCA 2277.

Engineered Systems, Inc. ASBCA No. 18241, 74-1 BCA 10,492.

Fairchild Stratos Corp., ASBCA No. 9169, 67-1 BCA 6225; motion
for reconsideration denied, 68-1 BCA 7053.

General Electric Co., ASBCA No. 4865, 60-2 BCA 2705.

H & J Construction Co., ASBCA No. 18521, 76-1 BCA 11,903.

K & M Construction Co., ENG BCA No. 3542, 76-1 BCA 11,847.

Kamen Soap Products Co., ASBCA No. 2587, 57-2 BCA 1366.

Kinn Electronics Corp., ASBCA No. 16440, 72-1 BCA 9288.

Legislative Resources, Inc., DCAB No. OMBE-16-74, 76-2 BCA 11,951.

Liodas (In re Argus Industries), ASBCA No. 12829, 71-2 BCA 9015.

Magnavox Co., ASBCA No. 17455, 74-1 BCA 10,495.

McCloskey & Co. v. Army, Office of Contract Settlement Appeals
Board No. 277, 4 CCF ¶ 60,901 (1950).

Navgas, Inc., ASBCA No. 9240, 65-1 BCA 4533.

Nolan Brothers, ENG BCA No. 2680, 67-1 BCA 6095.

North American Rockwell Corp., ASBCA No. 15863, 72-2 BCA 9490.

Power Equipment Corp., ASBCA No. 5904, 1964 BCA 4025.

Precision Switch Corp., ASBCA No. 13986, 69-2 BCA 8012.

Pamco Corp., ASBCA No. 3114, 57-2 BCA 1489.

Q.V.S. Inc., ASBCA No. 7513, 1963 BCA 3699.

R-D Mounts, Inc. ASBCA Nos. 14827, 14863, 14864, 14999, 15071,
15358, 71-1 BCA 8643; motion for reconsideration denied,
71-1 BCA 8725.

R-D Mounts, Inc., ASBCA Nos. 17422, 17668, 17669, 75-1 BCA
11,077.

Remsel Industries, Inc., ASBCA No. 8462, 1963 BCA 3918.

L.B. Smith, Inc., ASBCA No. 2350, 61-1 BCA 2998.

Southland Mfg. Corp., ASBCA No. 16830, 75-1 BCA 10,994; 75-1
BCA 11,272.

Stewart Avionics, Inc., ASBCA No. 10463, 65-2 BCA 5214.

Sundstrand Turbo, ASBCA No. 9112, 65-1 BCA 4653.

Switlik Parachute Co., ASBCA No. 18024, 75-2 BCA 11,434.

Technology, Inc., ASBCA No. 14083, 71-2 BCA 8956; motion for reconsideration denied, 72-1 BCA 9281.

Ted J. Grimsrud, ASBCA No. 7971, 1962 BCA 3562.

Thiokol Chemical Corp., ASBCA No. 17544, 76-1 BCA 11,731.

Topeka Janitor Service, ASBCA No. 9989, 65-2 BCA 4911.

Tuason Construction Co., ASBCA No. 5106, 59-1 BCA 2266.

West Lumber Sales, ASBCA No. 10879, 67-1 BCA 6101.

Western States Painting Co., ASBCA No. 13843, 69-1 BCA 7616.

Young Metal Products, ASBCA No. 15701, 71-1 BCA 8827.

Books and Articles

Brous, "Termination for Convenience: A Remedy for the Erroneous Award," 5 Pub. Cont. L.J. 221, Oct. 1972.

Carhart, "The Relationship Between Termination of Policies and Contract Law," Rand Paper Series, Aug. 1975.

Cuneo, Government Contracts Handbook, 1962.

Dounis & Foreman, "Historical Significance of Termination of Contracts for the Convenience of the Government," 14 Fed. Bar J. 191, July-Sept. 1954.

Gantt, "Termination in Federal Government Contracts," 7 Wm. & Mary L. Rev. 225 (1966).

Hardee, "Termination of Military Contracts," 32 Texas L. Rev. 172 (1953).

Lazure, "The Defense Department Termination Clause Impact on Contractors: A Problem in Contractual Differential Calculus," 14 Fed. Bar J. 213, July-Sept. 1954.

McBride & Wachtel, Cyclopedic Guide to Law, Admin. and Procedure on Government Contracts, vol. 4A, 1976 (sup.)

Mintz, "The 'Rule of Necessity' Makes its Impact Felt," The Washington Post, July 5, 1977, A4.

Mitchell, "Termination of Government Contracts: Recent Developments," 14 Wm. & Mary L. Rev. 817, Summer 1973.

Moss & Gantt, "A Steam Engine and Contract Termination Procedures," 8 Pub. Cont. L.J. 188, Dec. 1976.

Petit, "Post-Termination Costs," Briefing Papers, # 73-3, Federal Publications, June 1973.

Truegar, Accounting Guide for Defense Contracts (6th ed. 1971).

Wienshierk & Feldman, "The Current Challenge of Military Contract Terminations," 66 Harv. L. Rev. 47, (1952).

Wright, Accounting for Defense Contracts, 1962.

Wright, "Special Consideration in Accounting for Terminated Defense Contracts," 16 Fed. Acct. 38, Nov. 1967.

Miscellaneous

Defense Department Circular 79, 15 May 1970.

Uniform Commercial Code 2-302.

Statutes and Regulations

Anti-Assignment of Claims Act, 31 U.S.C. § 203 (1976).

Armed Services Procurement Regulations, 32 CFR 1-100 et seq. (subchpt A).

Armed Services Procurement Act of 1947, 10 U.S.C. § 2301-14 (1974).

Contract Settlement Act of 1944, 41 U.S.C. § 101, et seq. (1965).

Federal Procurement Regulations, 41 CFR, Chap. 1.

28 U.S.C. 2516(a).